PRODUCT LIABILITY

HEARING

BEFORE THE

SUBCOMMITTEE ON GENERAL OVERSIGHT AND THE ECONOMY

OF THE

COMMITTEE ON SMALL BUSINESS HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

SECOND SESSION

STAMFORD, CT, MARCH 24, 1986

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PRODUCT LIABILITY

MONDAY, MARCH 24, 1986

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GENERAL OVERSIGHT
AND THE ECONOMY,
COMMITTEE ON SMALL BUSINESS,
Stamford, CT.

The subcommittee met, pursuant to notice, at 9:42 a.m., third floor auditorium, Stamford Ferguson Public Library, 1 Public Library Plaza, Stamford, CT, Hon. Nicholas Mavroules (chairman of the subcommittee) presiding.

Mr. MCKINNEY. I think we will start, ladies and gentlemen.

We have a tremendous schedule to get through, and the chairman has to return to the Elysian fields of Massachusetts.

Good morning and thank you for attending this hearing on product liability. I would like to introduce the Honorable Nicholas Mavroules, chairman of the Subcommittee on General Oversight and the Economy.

As members of the Small Business Committee, Mr. Mavroules and I have been receiving numerous letters from small business and community leaders around the country. We felt it was crucial to begin a series of hearings to examine this crisis in order to hear firsthand about its devastating effect on small businesses.

We also will hear firsthand from the insurance industry, the legal profession, and the consumer groups. I thank all of the witnesses in advance for their cooperation and, now, I will hand the microphone over to my chairman, Mr. Mavroules.

OPENING STATEMENT OF CHAIRMAN MAVROULES

Mr. MAVROULES. Well, thank you very much, Stew.

I am delighted to be here with you and the people of Connecticut, particularly here in your district.

I am very pleased to see so many people turn out here this morning, Stew. It is a good sign.

As you all know, we are here to discuss the crisis in liability insurance, particularly product liability, and how this is affecting our small businesses. There is no question about the existence of this crisis. It is being felt nationwide and insurance premiums for small businesses have jumped by 300 to 1,000 percent, while only a fraction of the previous coverage is being offered.

In my own district of Massachusetts, many businesses cannot get the required insurance coverage needed to operate. Child care centers are being denied insurance completely and have been forced to close. Small manufacturers have been forced to make major cuts

and drastic changes in production. Some doctors have stopped providing certain services, all this because they cannot get the required insurance coverage.

Product liability has been gaining national attention over the past few years, and the degree to which manufacturers are responsible for their products has reached exorbitant levels. Court and jury awards against manufacturers have been increasing, both in the size of awards and in the number of cases being brought to court.

Product liability is only a part of the current insurance liability problem facing small business. Besides the increasing court awards, the insurance industry has found itself overextended and has now begun to reduce its own liability. Insurance companies have begun reducing risks and increasing premiums to ensure that they maintain a profit margin, and it's now becoming practically impossible for small manufacturers to obtain product liability insurance or any liability insurance at all, for that matter.

Small businesses often have nowhere to go when their insurance is cut off or when rates are too high and coverage too little. While larger businesses have the ability to start self-insurance groups, hire risk managers, go offshore, cut out a certain product, or even pay the higher premiums, small businesses have less leverage and fewer options. Unfortunately, the small guy, who was least responsible for the problem in the first place, bears the greatest burden.

Among politicians in Washington, product liability is a "hot" issue. This has its good side and its bad side. The crisis is getting a lot of attention and scrutiny, which is good. Looking carefully at the problem and discussing possible solutions is what we need. On the other hand, there is a great sense of urgency and pressure to quickly pass legislation to ease the crisis. This is not so good, because treating the symptoms may not necessarily cure the disease. The long-term effects of a hasty solution might cause more problems than they solve.

We have asked the witnesses here today to describe for us, from their point of view, the causes of, effects of, and solutions to the product liability crisis. The purpose of our discussion is to hear all sides of the problem. We are not here to blame any particular party, but to hear them out. Most importantly though, we want to hear from the small businesses. They are the ones that are suffering the most and are in most need of help.

I am looking forward to hearing the testimony being presented this morning. As I mentioned before, product liability has reached a crisis stage and we are all anxious to resolve it once and for all.

I just want all of you to know I am delighted to be with you and my colleague, Stew McKinney, who has been getting the same kind of complaints I have over the past couple of years.

And, now, I would like to turn it over to Mr. McKinney.

OPENING STATEMENT OF HON. STEWART B. McKINNEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CONNECTICUT

Mr. McKINNEY. Increasing costs and a scarcity of liability insurance has created a national crisis for all sectors of the economy,

especially the small business sector. Letters citing increases in premiums, cancellation of policies, and insufficient coverage have poured into my office as well as into the chairman's office.

Let me give you some examples of the problems Connecticut and its businesses are having because of the lack of and the high cost of general and product liability.

Westport Apple Festival and the Westport-Weston Cooperative Nursery School Craft Fair may not occur this year because of the high cost of liability insurance. From 1984 to 1985, Westport carried 11 million dollars' worth of insurance for a cost of $180,000. Today, the town has a $6 million package that costs $560,000. Additionally, because of the risk involved in running these events, the town may decide not to hold them due to lack of adequate liability.

That, I would state, is a change in the basic social fabric of the way our towns operate.

Mr. Kenneth Schwartz, president of SATTVA Chemical Corp., Stamford, CT and one of our witnesses, wrote to tell me that his insurance was $1,800 in 1984 for a $1 million product liability policy, and $40,000 in 1985.

Mr. Ernst Schindele, chief executive officer for Fairfield Medical Products, wrote to tell me that his renewal premium for $500,000 of coverage will increase from $10,000 to $38,000 for the first $2 million of sales. After that, $25 will be charged for every $1,000 in sales or a total of $25,000 for an additional million. Fairfield Medical Products employs 40 people in my district and expects to do $1 million in sales thereby estimating its 1986 insurance costs to be $63,000. Remember, it was raised from $10,000. Unfortunately, other companies, such as Mr. Campbell's consider Fairfield Medical Products lucky. At least they have insurance; whereas, Mr. Campbell has received a cancellation notice.

Who do we blame for this impossible situation? From what I have heard and read, many fingers are pointing and they are pointing at many sources. Consumers argue that defective products should be off the market and what better way than to win a large award from deep pockets.

Insurance companies argue that their rates are not unreasonable if one looks at the facts that they see. There are 32 different ground rules. On top of that, the awards given by judges and juries are large. They simply cannot expect to stay in business when one or two cases can wipe them out. The legal profession, which has been taking most of the heat, argues that insurance companies do not share their claims records to verify their increases. They also claim that the outrageous cases we have read of are not the norm.

If everyone is right and believes their arguments are correct, why are small businesses going down the drain? We are here to hear the problems and gather some suggested solutions. Small businesses employ nearly half of the people in this country and have sparked more than half of the new jobs created. Under our present system, no one is winning this battle. Consumers are paying more for their goods while legitimate claims are getting lost behind frivolous suits. Some are overcompensated for injuries, while, tragically, many are undercompensated. Finally the high cost of insurance is preventing many from entering into a small business and forcing many well-established small businesses out of the market. Does the

Federal Government have a vested interest in helping to resolve the problem? That is why we are here and I would suggest that under Interstate Commerce, we do.

Thank you very much, Mr. Chairman.

Mr. MAVROULES. Thank you very much, Stu.

This morning's hearing will include five panels. We were to have had Mr. Ward Brown with us this morning, but it is my understanding he is quite ill. So, without objection, we do have a prepared statement, and I will include that in the record in its entirety.

[The statement referred to is in appendix E.]

The three witnesses for panel 1 this morning include Peter Gillies, commissioner, department of insurance; Murray Gerber, Small Business Advisory Council, department of economic development; and John O'Connor, University of Connecticut, Connecticut Small Business Development Center.

If all three gentlemen are here, I would ask you to come to the witness table, please.

[Pause.]

Mr. MAVROULES. We are now prepared. Mr. Gillies, if you would, please proceed with your testimony.

TESTIMONY OF PETER GILLIES, COMMISSIONER, DEPARTMENT OF INSURANCE, STATE OF CONNECTICUT

Mr. GILLIES. Good morning. I thank you for inviting me to be here.

I am Commissioner Peter Gillies, insurance commissioner for the State of Connecticut.

I do not have any prepared remarks as such. I just wanted to discuss very briefly with you the kinds of things that are taking place here which are not unique to Connecticut. They are happening in Massachusetts and other States as well.

May I say at the outset, however, that to the extent that the Connecticut Department of Insurance can be of any assistance to you gentlemen or your subcommittee, please feel free to ask for that assistance. Anything that we do not have, we will obtain, and do so as quickly as we can to assist you in the kinds of deliberations that you are engaged in.

The background, I think you are fairly familiar with how we got to where we are today, the pricing policies of the insurance industry over a period of years where they were prepared to undersell their product without concern to the risk involved in order to garner a share of the market, is well documented, and if we could simply say to the insurance industry, increase your prices even dramatically and expect, as a result of that, that we would see a return to a normalcy of marketplace and an availability of insurance, I think all of us could fairly predict that will occur.

But, unfortunately, there are other factors involved in this entire problem that do not lend themselves to this kind of quasi-easy solution. The whole question of availability, which is the paramount one that faces us today, has at its root caused so many variables, none of which are easily identifiable and none of which are easily solvable, that it is necessary for us to look very closely at them.

Both sides have tended to overstate their positions, which is not to be wondered at. I think the insurance industry may, in certain instances, have overstated the kinds of severity of injury that they are anticipating and have not, even to this day, carefully analyzed all of the risks that are out there in an attempt to determine whether or not this particular risk or group of risks are such that we could underwrite them at what would be more reasonable rates.

On the other hand, they are operating in a climate where the ground rules seem to change with each passing day, so that what was suitable for coverage last week, through a court interpretation or an expansion of concepts of liability, is no longer the same kind of risk.

We see this particularly in the product liability area, where there has been an imposition of liability without regard to fault or failure or negligence in manufacturing. If an injury has occurred as a result of the use of a particular product, it is almost an ipso facto situation, that the manufacturer is liable for that product because an injury occurs.

I think we have moved so far afield in that kind of an area that it makes it virtually impossible for a manufacturer or a products developer to even consider entering into new or untested waters. So, when we make that observation, it seems to me we must then say well, what is causing that, why is there a change, and I think that it is a number of factors, one of which is a societal one.

The general public seems to be of the perception that if an injury occurs, they, therefore, are entitled to compensation for it, and how that compensation is going to take place is generally viewed as a responsibility of an insurance industry, and I think it is necessary for us to all step back a pace or two and say of the insurance industry, not of the industry necessarily itself, but of our own collective judgments as to industry, what is it they can do? What is it they should be required to do, and to the extent that we are imposing upon that industry obligations which it simply cannot undertake, for example, the cleaning up of hazardous waste sites? That is a burden that no insurance company was ever designed or can possibly attempt to assume.

So, those kinds of things have to be addressed. I think rather than sit here, gentlemen, and go on as I am doing, it might be more helpful if I just cut off my remarks at this point and prepare to answer any questions you may have.

Mr. MAVROULES. Very good. We appreciate the testimony. If you would just stay with us for awhile, we are going to listen to Mr. O'Connor, then we will have a few questions for you.

Mr. GILLIES. Fine.

Mr. MAVROULES. Mr. O'Connor, if you would proceed.

TESTIMONY OF JOHN O'CONNOR, STATE DIRECTOR, CONNECTICUT SMALL BUSINESS DEVELOPMENT CENTER, UNIVERSITY OF CONNECTICUT, STORRS, CT

Mr. O'CONNOR. Thank you.

My name is John O'Connor. I am the State director of the Connecticut Small Business Development Center, which, for the record, is a partnership between the university, the private sector, the Fed-

eral Government, and the SBA, and the Connecticut State Legislature.

Its purpose is to serve the small business community through training them and counseling.

My testimony is to reflect our experience to date. It is not intended to identify any solutions through litigation or legislation. The majority of—the makeup of our constituency ranges from about 30 percent which are made up of people who are just thinking about going into the business and their reflection in terms of expressing concerns about insurance problems would probably be shown in the cost of liability insurance and their original business plans, which might essentially eliminate their viability as a future company.

Our experience to date has been through our six operating offices throughout the State. We experience about two to three complaints per month from each office, and they are primarily coming from that category of people who have been in business from 1 to 2 or 3 years, and who are already in trouble, which is the primary clientele that comes to our offices.

Ten percent of our clientele body is made up of people who are successful over 5 years in business. They will more likely go to a professional for profit type organization seeking the solutions to these types of problems.

Our perception is there is a problem out there. We do not, through our yearling position, see it clearly because of the makeup of our program. As I said before, I am not in the position to suggest how to solve it.

[Mr. O'Connor's prepared statement follows:]

PREPARED STATEMENT OF JOHN O'CONNOR, STATE DIRECTOR, CONNECTICUT SMALL BUSINESS DEVELOPMENT CENTER, STORRS, CT

My name is John O'Connor and I am the State Director of the Small Business Development Center at the University of Connecticut. I have come here today to testify for the General Oversight and the Economy sub-committee of the House Small Business Committee on product liability insurance costs. My remarks will be based upon my background as the State Director of the Small Business Development Center which is a cooperative partnership amongst the University of Connecticut, the Federal Government through the Small Business Administration, the State of Connecticut's Legislature and the private sector of the State of Connecticut. The responsibilities of the Small Business Development Center are to provide and make available one-on-one professional counseling and education through courses and conferences to the small business community of the State of Connecticut. In this capacity, we are in daily contact with clientele that last year numbered 1500 companies or individuals consulted and over 3600 individuals who attended our educational programs.

The subject of this hearing is product liability insurance and particularly how it relates to the small business community. It is a subject that has been growing in intensity over the past year with the clientele that we interface with.

The purpose of my testimony is to share with you the depth of this concern that we have observed in our clientele and not to try to speak to a solution. We deliver our services from eight principle offices that are located in Chambers of Commerce throughout the State of Connecticut. These offices are staffed by full-time consultants on a five day a week basis. Our experience to-date is that in each one of these offices we are encountering two or three cases a month, on an average, of clientele coming to us seeking assistance and advice on how to deal with the rising liability insurance costs. The people in question are identifying premium cost increases ranging from 100 to 300 percent. At the same time, because of our interest in the problem, our own inquiries into other clientele that we deal with regarding their product liability insurance concerns has shown that their experiences to be quite different. In these cases, they are indicating, through careful scrutiny of vendors, that they have experienced only a modest increase in their premium costs.

It is important to note that the Small Business Development Center audience is made up of 30 percent starting a new business, 60 percent people in business 1-4 years with sales less than $500,000, and 10 percent 5 years old and older with sales in excess of $500,000.

The first 30 percent are not an issue; yet, in this debate or at best are in a position where liability insurance costs could be the deciding factor in the viability of their business plan.

The 60 percent 1-4 years are the group most likely to seek our assistance and are reflected in our stated experience. There is a suspicion that some of these clients are going bare in lieu of high liability premium costs that can be the difference between profit and loss.

The 10 percent group 5 years old and older are more sophisticated and successful. They are more likely to seek advise from the private sector.

We have concluded that there is a serious problem, but it does not appear to be an across-the-board problem for the CSBDC clientele. We are uncertain as to what the causes of this difference might be. The existence of a serious problem in certain quarters is more than evident in actions, such as this committee, the national journals and newspapers and the attention the subject is receiving in our own state legislature in Connecticut.

In conclusion, the CSBDC confirms that there is a problem affecting the small business community product liability insurance costs, but the problem does not seem to be affecting the majority. The corrective solution to the problem I leave to the specialist who administer and litigate product liability questions.

Mr. MAVROULES. Very good. Thank you.

I have a couple of questions. I am sure my colleague, too, will have a number of them.

Are you familiar with the task force put together by President Reagan and its recommendations? Let me just read this one paragraph, and I would like both of you to comment on it:

> The Assistant Attorney General, Mr. Richard K. Willard, presented an 80 page report aimed at making insurance more available and affordable. The recommendations included a $100,000 ceiling on non-economic jury awards for pain and suffering, reductions in attorneys fees for 50 percent or more, allowing defendants who lose to pay for economic damages over time, and the elimination of joint and several liability.

I do not know if that is your sphere, but I would like to get your feelings on these recommendations from the task force, if you would.

Mr. O'CONNOR. I do not think we are in a position to really comment, Congressman, for the simple reason that the information that keeps flowing to us, we hear multitudes of opinions as to which is the right way and which is the wrong way to do it.

I think people more sophisticated in the various areas of those professions are better.

Mr. MAVROULES. Do you feel we have reached the point today where the U.S. Government, the Congress, should be involved in discussing insurance legislation?

Mr. O'CONNOR. I think the problem is serious enough that it commands the attention of Congress, yes.

Mr. GILLIES. I certainly think in certain areas it does. I am, as you know, a regulator at least for the past number of years, been a State regulator, and I can think that that is the best way to approach this entire problem.

There are areas, however, where the Federal Government can take a very strong role and should do so, particularly in the CIRCLA and the environmental protection areas, where they are imposing joint and several liabilities. Impositions of liabilities on municipalities or individuals has reached a point of uninsurability.

The very manner in which the statute is drafted almost dictates that no insurance will be available to cover the situation, and that is a federally mandated situation.

I think that the kinds of things that are being discussed here, your caps on liability and that kind of thing, are universal at this point. Fifty States have task forces which have been appointed by their respective Governors. Each of them looking at availability and cost. Each of them, I think, the singular climate runs through all of them, they are all coming up with the same kinds of general proposals. The elimination of joint and several liability. Contribution of joint tort features. The collateral source rules. Modification of those. Some adjustment of contingent fees.

Connecticut, in its task force, recommended that the legislature consider caps on an award, recognizing two aspects of it; one is that the general recommendation of caps on awards for the general public may not pass constitutional muster, and there was some reservation expressed by the committee as to whether or not the legislature could do that in the general area.

In the area of muncipal liability, however, it was the considered opinion of the committee that there were different considerations at play, and that a cap on awards in those areas might be feasible and was recommended.

I think each legislature is going to be grappling with those kinds of suggestions, and we will be seeing them take place in the individual States, and I think it makes sense to have it on the individual States because the liabilities that are being imposed are different to each State.

The rules of punitive damages as they are assessed in Connecticut are considerably different than those in California, and, so, it lends itself to individual State solutions because so many of the suits that are brought will never find their way into a Federal court system. They are litigated in our State courts under State laws.

Mr. MAVROULES. You are talking about the States, and I agree with you, by the way. What do you feel should be the role of the Federal Government in relation to the problem we are talking about this morning?

Mr. GILLIES. I have not pinpointed specifically, Congressman. I guess I have been so involved in trying to solve it on a State level that I have not switched over to how the Federal Government can intercede.

I think the mere fact that there is this discussion taking place indicates that there is a nationwide problem—not a Connecticut, or a Massachusetts, or a North Dakota problem, but a nationwide one—forces us and has forced the various States to come to grips with it in a fashion that 5 years ago would not have been possible.

If anybody suggested to me when I was in the legislature with Stew a number of years ago, and those were the good years, when we had money and you could solve problems, and——

Mr. MCKINNEY. And we had fun.

Mr. GILLIES. Yes; even though he was on the wrong side of the aisle, right.

If anybody suggested tort reform then—impossible. Now, you have all aspects of society. It is impacting every single facet of the way we live.

We have here in Connecticut a market assistance plan. I sent notice to the directors of that plan last week that I expect them to sit down tomorrow with me and discuss the availability of amusement park liability. This is our 350th anniversary. We have a lot of functions that are supposed to take place, none of which will take place unless there is some kind of insurance available, and we mandate by legislature that there be $1 million of coverage.

So, we, on the one hand, are saying you must have it; on the other hand, we have no mechanism to provide it. So, I am looking to them, that is, the industry, to work with me to provide that mandated coverage. But that is, you know, just one tiny part of it.

Mr. MAVROULES. Stewart?

Mr. MCKINNEY. You have asked the really important question, which is: What is the Federal role?

Can the States really regulate insurance any more? We have 51 separate, individual insurance commissioners, the District of Co-

lumbia and 50 States. Do you think that there is ultimately that much power? I am talking about your own child, of course, but——

Mr. GILLIES. I think that the answer to that question is yes, and I think what has been demonstrated is an affirmative to that.

There is, of course, a great deal of criticism being heaped upon the State regulators for their inability or failure to perhaps identify this problem early on, come to grips with it, and provide solutions before it took place.

But when you stop and think about how we got to where we are, a great portion of that end result was a pricing warfare that took place within the insurance industry itself. Prices did not go too high. They went too low by a very substantial margin, and I question any municipality whose insurance had gone down dramatically from its prior rate, and said Mr. First Selectman or Mr. Mayor, let me tell you this: Those rates are too low, and they have got to go back up substantially. I do not think I would have stayed in office for very long. People do not want me coming in and saying the prices are too low; they want me to come in and say the prices are too high.

There is nothing wrong with that, except that the entire regulatory structure that we had in the States was geared primarily to solvency review. That is what we were aiming our entire mechanism at: Could the companies that were writing business in this State meet their financial obligations? It was a solvency question, and the data and information that we required the company to provide us was garnered for that specific purpose.

Now, the games have changed a tad, and the kinds of information that we now need are different. We still need a solvency question, but we also need market conduct answers. Most States do not have at their disposal the kinds of information and data that would provide the tools to make those judgments.

I do not know by line of insurance what the profit and loss are or what the premium is for a specific line. I have filed rates, but I cannot tell through deviations and so forth what their experience is. I have before the legislature a bill which I know will pass that will provide me the mechanism to require by line of insurance data. The companies will now have to provide me with both their loss experience and their profit experience.

I did not need that 5 years ago because the marketplace was very effective. If you did not like the rate you had with your company, you went across the street and bought it from somebody else. Now, we need it.

I have also requested and am receiving money for market conduct examiners, people who can go into the field and do the kinds of analyses that have to be done.

So, when we look at what State regulators have accomplished or done, I think it is important to look at what they have done within the framework of their existing statutory mandate, to the extent that that statutory mandate needs modifications.

My test for review of a company by statute for inadequate rates is: Would those rates result in an insolvency? Now, I would be hardpressed to pick any rate that a particular insurance company charged over the past few years and say that if it continued to file

that rate or use that rate, you will go insolvent. They were able to offset those losses by some other mechanism.

So, the test was wrong; but now, I think, we are in a better position to identify what we need, and I think the States are in the best position to do it.

Let me, if I may, draw your attention to a bill that is before the Congress now. It is in the Senate, and I would urge both you gentlemen to look at it. It concerns a risk retention bill. It is Senate bill 2129. It is in markup now. It is a very, very serious piece of legislation that is designed, as sometimes legislation is, on a motherhood issue sort of thing; it is good and, therefore, it will go.

Mr. MAVROULES. Who are the authors of that bill?

Mr. GILLIES. I do not know, Congressman. But, what it does is it provides for a homegrown insurance company and they will not be monitored, they will not be subject to any kind of scrutiny by the State regulatory authority, so that I will not be in a position to say, when a company comes in and says they are going to write day care coverage, whether or not that company is solvent, and the only thing that that is going to do is there is going to be a lot of paper out there that says insurance on the top of it that is not worth the powder to blow it to hell.

Mr. MCKINNEY. Congress does those, too, Peter, though, in the banking business. They are called network certificates.

Mr. GILLIES. Well, I just had a company come in that was ostensibly going to write amusement park coverage, and I brought them in and asked them what their net worth was and whatever. This was going to be a nationwide data, $1 million of surplus, and I said that is ludicrous. You know, how can you possibly do that. They left the room. An hour later they came back, and, miraculously, they now had $2.5 million in surplus.

Mr. MCKINNEY. John, do you have anything you want to add to that?

Mr. O'CONNOR. No, Mr. Congressman, other than the fact that we reconfirm that the problem is there, and I think it is affecting small business, and I am afraid there are a few people out there going bare.

Mr. MCKINNEY. You say the problem is there, and, Peter, I would say that the problem is there also. You know that if you cannot serve on the zoning board of appeals in Westport, CT, for free and get umbrella liability? I mean, the whole basis for Government is to do all these idiotic things late into the morning on a free basis, whether it is the school board or the zoning board or the zoning board of appeals or the park and I think we cannot turn around and say to people, you cannot get liability insurance because someone is going to sue you.

Mr. GILLIES. But I think we have got to look at that, not from the standpoint of do we require liability insurance, but should we not provide immunity to these people. The United States of America is run by volunteers.

Mr. MCKINNEY. Money for this library was raised by volunteers, as we are sitting right here.

Mr. GILLIES. I am sure. I am sure. And should not they be provided simply—is it not a value to the American people that the Red Cross or the United Way or whatever, that they ought to be simply

free, absent some culpable negligence where you have gone out and done something—you know, that is—but the general activity, immunity.

Mr. MCKINNEY. Well, I think you, as insurance commissioner of the State of Connecticut, and the small business groups' interest in it, is why we are here.

What is the insurance crisis doing to the social fabric of our whole and all 51 governmental locations? No. 2, is insurance available? No. 3, if it is available, can you afford it because insurance is, in essence, and I should not say this because it will inflate your ego here, almost a utility at this point.

You do not leave home without it. It becomes sort of our motto to coin an advertising adage, and I was laughing as the father of five that you carry your doctor's number, your wife's doctor's number, and your insurance company information in your wallet because you never know when one of the kids is going to call up and say, "Pop, it happened."

Thank you very much, gentlemen.

Mr. MAVROULES. Thank you, gentlemen. I appreciate your testimony very much.

Mr. MCKINNEY. And, again, if there is anything our office can provide——

Mr. MAVROULES. I am sure we will be talking with you. It is a big problem that we are all very concerned with and, quite honestly, we do not have any answers to it at this point.

Mr. MCKINNEY. Quite honestly, neither do I.

Mr. MAVROULES. Thank you. For our second panel, we will hear from Francis Doyle, Director of Government Affairs at the Small Business Service Bureau; John Rathgeber, Connecticut's Business and Industry Association; and Tom Chittenden, American Insurance Association.

[Pause.]

Mr. MAVROULES. Welcome, gentlemen.

Mr. Doyle, you will be our leadoff witness.

TESTIMONY OF FRANCIS X. DOYLE, DIRECTOR, GOVERNMENT AFFAIRS, SMALL BUSINESS SERVICE BUREAU, INC., WORCESTER, MA

Mr. DOYLE. Thank you. Good morning, Mr. Chairman, and Congressman McKinney.

For the record, my name is Frank Doyle. I represent the Small Business Service Bureau. We are a national small business organization based in Worcester, MA, but we do have 4,000 members here in Connecticut and, of course, 8,000 up in Massachusetts.

And, what I would like to do is to present some of the findings that we found on how this problem is affecting our members and some of the areas that we think are tangible recommendations for either Federal or State action. What I will do is to address the general liability question because we feel that, by and large, what affects a business in product liability is very much the same as medical malpractice or any type of liability a business is exposed to.

But, we would like to see the Small Business Committee itself work toward what can be short-term relief for businesses facing

this problem, but perhaps also develop what could be model legislation that can address both the civil justice and the insurance reform that is needed on a national level.

Small businesses have been hit particularly hard. We found that our members through any State in the country have been hit with premium prices ranging from 50 to 2,000 percent, and many business owners have been unable to buy coverage at any price and, at this point, are going bare or risking what essentially can mean that they go broke.

Despite the fact that 85 percent of our members have been free from any claim made against their business, almost half of them have had premium increases exceeding 50 percent. Product liability, in particular to those that are exposed to it, the manufacturers, has caused 31 percent of them to actually go bare, with no coverage whatsoever, and 12 percent of those in the manufacturing and product development sector have actually had to close their doors or drop new product lines that they were developing.

Nothing, we feel, demonstrates this problem better or actually worse than the fact that companies are closing their doors, not because a claim has been made against them for any negligent act, but because of the total risk of being unprotected.

Selfinsurance and reinsurance are very good options for larger businesses, but only about 9 percent of small firms are eligible or large enough to even consider selfinsurance. The others that do not go bare either drop product lines, which we find is about 5 percent of the firms, or increase their prices, which about 55 percent are faced with doing at this point.

I have several examples in my testimony, which I will leave in the written record as opposed to going through each one. We find that larger companies and that the insurance industry also maneuver to protect themselves from the deluge of claims and lawsuits. Small businesses are out there on their own.

Some small firms have had their policies canceled, with no advance notice from the insuror, and others find that even if they can obtain coverage, they cannot get adequate protection. So, the level of coverage has dropped as the price has gone up.

Large corporations can pool their resources to self-insure, but small businesses often have no choice. In order to obtain a liability policy of any type, many small firms are forced to switch all their insurance from one carrier to another, thus leaving them without any choice in the marketplace.

Not only are they being gouged by exorbitant premiums, but they are being denied the freedom to shop for the most competitive price for their insurance needs.

Additionally, we find that many insurance carriers now will only write policies which will pay claims made during the policy period, and while this seems like a very small part of the problem, if you carry it forward, this will leave a very long trail of liability for any firm buying what is perhaps the only coverage they can afford because any accident caused where the claim is not filed beyond that year of coverage time, they will be completely exposed to it, despite the fact that they did have coverage during the manufacturing period.

Ironically, a large part of the blame for this very sorry state of affairs can be placed squarely on the shoulders of the insurance industry itself. As the Commissioner alluded to, during the 1970's, when interest rates were very high, a lot of insurance companies engaged not in true underwriting but in cash flow underwriting. Slashing premiums to expand their share of the market resulting in rates which were too low to cover their risks, although, of course, I will admit that not so low that the consumers were complaining of the lesser price.

We feel that the legal system itself has added to the problem, and that the tort system is very much devoid of consistent predictable standards. Congressman McKinney, you referenced the fact that there are 51 different systems throughout the country that you could be subject to in any particular claim, and we feel that this is something which can be addressed federally as legislation has been filed in each of the last three sessions that I am aware of to create a uniform product liability standard.

The legal system, as it adds expenses, we find has been spending nearly $3 in legal and administrative fees for every $1 awarded to plaintiffs.

Additionally, there is a misconception on the part of juries and the general public that no one is hurt by big damage awards because insurance companies are footing the bill. Jury awards in liability cases are often predicated on the ability of the defendant to pay, not on wrongdoing. It may appear to a jury that a defendant with deep pockets is paying the claim; the truth is that the money is coming out of millions of little pockets in the form of higher prices and higher premiums.

Small Business Service Bureau believes that a multi-faceted approach is very much needed. Many partial or stopgap measures have been implemented to date. The sliding scale limit on lawyers fees in California has been upheld in the courts. Bills filed in many States seek to limit non-economic awards or to further restrict the definition of reasonable doubt and of liability itself.

Some of the recommendations that we have made in other forums and to your colleagues in the Senate include that laws and regulations that limit or prevent cancellation of liability policies within the policy period are needed. That advance notice of at least 90 days should be required in any instance where an insuror will not renew a policy. That, perhaps, SBA's 800 line or the Commerce Department offices could have information to help people in their shopping, as the Commissioner mentioned is being done here in Connecticut, a market assistance role strictly referring them to people that are still writing coverage.

A uniform product liability statute on the Federal level could and should be implemented. A systemized limit on attorneys contingency fees could be enacted in each State. Punitive damages should be applied only in cases when wrongdoing is truly beyond a reasonable doubt.

Again, one of the problems is that the definition of liability has expanded tremendously.

There are a few other points in my testimony that make reference to Senate bill 1999, Senator Danforth's bill, and Senator Kas-

ten's bill, Senate 100, which I am sure both the chairman and Congressman McKinney are familiar with.

I think that within the scope of your role as members of the oversight subcommittee and of the full committee membership, not only is this whole problem very much under your jurisdiction, but something that can be approached from the Federal role and something that very much deserves the attention of the full committee itself.

I would like to conclude at that point and answer any questions at the end of the panel.

[Mr. Doyle's prepared statement follows:]

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PREPARED STATEMENT OF

FRANCIS X. DOYLE

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BEFORE THE

HOUSE COMMITTEE ON SMALL BUSINESS

SUBCOMMITTEE ON GENERAL OVERSIGHT AND THE ECONOMY

REGARDING

LIABILITY REFORM

MARCH 24, 1986

GOOD MORNING MR. CHAIRMAN AND CONGRESSMAN MCKINNEY, I AM FRANK DOYLE, DIRECTOR OF SMALL BUSINESS SERVICE BUREAU (SBSB). SBSB IS A NATIONAL SMALL BUSINESS ORGANIZATION WITH 35,000 MEMBERS HEADQUARTERED IN WORCESTER, MASS. WE PROVIDE SMALL BUSINESSES AND NEW BUSINESS START-UPS WITH LEGISLATIVE ADVOCACY, MANAGEMENT ASSISTANCE, HEALTH INSURANCE AND OTHER BENEFITS AND SERVICES.

THIS MORNING I AM PLEASED TO BRING YOU THE DETAILS OF OUR RESEARCH INTO THE IMPACT THE LIABILITY CRISIS IS HAVING ON OUR MEMBERS AND OUR RECOMMENDATIONS ON HOW TO SOLVE IT.

THE COMMITTEE SHOULD WORK TO PROVIDE SHORT-TERM RELIEF FROM LIABILITY INSURANCE INCREASES, AND DEVELOP MODEL LEGISLATION THAT CAN ADDRESS THE CIVIL JUSTICE AND INSURANCE REFORM THAT IS NEEDED.

THE LIABILITY INSURANCE CRISIS IS THREATENING THE ECONOMIC HEALTH OF THE ENTIRE NATION. THE LITIGATION EXPLOSION AND SUBSEQUENT SKYROCKETING INSURANCE RATES ARE RESPONSIBLE FOR BUSINESS CLOSINGS, HIGHER TAXES, HIGHER HEALTH CARE COSTS AND HIGHER PRICES FOR ALMOST EVERYTHING. SMALL BUSINESSES ARE BEING HIT PARTICULARLY HARD. SBSB MEMBERS IN EVERY STATE ARE BEING CONFRONTED WITH PREMIUM HIKES RANGING FROM 50 TO MORE THAN 2000 PERCENT, AND SOME BUSINESS OWNERS HAVE BEEN UNABLE TO OBTAIN COVERAGE AT ANY PRICE. MANY SMALL BUSINESSES ARE FINDING THAT THEIR ONLY OPTIONS ARE TO "GO BARE" OR GO BROKE.

DESPITE THE FACT THAT 85 PERCENT OF OUR MEMBERS HAVE NOT HAD ANY CLAIMS FILED AGAINST THEM, ALMOST HALF HAVE HAD PREMIUM INCREASES EXCEEDING 50 PERCENT. PRODUCT LIABILITY IN PARTICULAR HAS CAUSED 31 PERCENT OF THOSE EFFECTED TO "GO BARE" AND 12 PERCENT TO ACTUALLY CLOSE THEIR DOORS AND GO OUT OF BUSINESS. NOTHING DEMONSTRATES THIS PROBLEM BETTER THAN THE FACT THAT COMPANIES ARE CLOSING NOT TO PAY A HIGH CLAIM BUT JUST BECAUSE OF THE TOTAL RISK OF BEING UNPROTECTED.

SELF-INSURANCE AND RE-INSURANCE ARE GOOD OPTIONS FOR "CORPORATE AMERICA", BUT TODAY ONLY 9.1 PERCENT OF SMALL FIRMS ARE ABLE TO CONSIDER SELF-INSURING. THE OTHERS THAT DON'T GO BARE EITHER DROP THEIR PRODUCT LINES (5.4 PERCENT) OR INCREASE THEIR PRICES, WHICH 55.8 PERCENT WERE DOING.

HERE ARE SOME EXAMPLES OF HOW THE LIABILITY CRUNCH IS HURTING SMALL BUSINESS, TAKEN FROM OUR MEMBER'S EXPERIENCES:

- AN SBSB MEMBER IN NEW HAMPSHIRE OPERATING A SANDBLASTING SERVICE HAD TO SCRAP PLANS FOR EXPANDING HIS BUSINESS AND HIRING MORE EMPLOYEES WHEN HIS LIABILITY PREMIUM INCREASED TO EQUAL HIS TOTAL ANNUAL SALES;

- A MASSACHUSETTS MEMBER OPERATING A SCHOOL BUS COMPANY HAD TO PAY A $10,000 PREMIUM TO OBTAIN THE SAME AMOUNT OF COVERAGE THAT HAD COST HIM $3,000 LAST YEAR;

- ANOTHER MEMBER OPERATING A SMALL HOTEL AND TAVERN EXPERIENCED A PREMIUM INCREASE OF MORE THAN 2,000 PERCENT, FROM $600 TO $13,000 IN ONE YEAR, WITH ONLY $15,000 IN CLAIMS OVER A 25 YEAR PERIOD - AND THIS DID NOT INCLUDE LIQUOR LIABILITY;

- THE OWNER OF AN ASBESTOS-REMOVAL FIRM HAS BEEN UNABLE TO FIND ANY INSURANCE CARRIER WILLING TO UNDERWRITE LIABILITY COVERAGE. IN THIS CASE, A VITAL SERVICE WHICH IS MANDATED BY LAW CANNOT BE PERFORMED BECAUSE THE PROVIDER OF THIS SERVICE CANNOT OBTAIN THE COVERAGE SHE NEEDS TO RUN HER BUSINESS;

- A VIRGINIA MEMBER WHO DESIGNS UNDERGROUND STORAGE TANKS FOR GAS STATIONS FIRST SAW HIS PREMIUM JUMP FROM $380 TO $8,800. WHEN A NEW FEDERAL REGULATION WAS PASSED WHICH AUTHORIZED FINES OF $10,000 PER DAY ON EACH TANK THAT WAS FOUND TO BE LEAKING, INSURANCE COVERAGE COULD NOT BE PURCHASED AT ANY PRICE. HE IS NOW OUT OF BUSINESS.

- A TABLE SERVICE RESTAURANT IN NEW YORK WHICH SERVES AN OLDER CLIENTELE RECENTLY HAD ITS LIQUOR LIABILITY COVERAGE WITHDRAWN BY ITS INSURER. NOT A SINGLE CLAIM HAD EVER BEEN FILED AGAINST THE BUSINESS. LAST YEAR, THE OWNER PAID A $750 PREMIUM FOR $500,000 WORTH OF COVERAGE. HE NOW PAYS $980 FOR A $100,000 POLICY THROUGH ANOTHER INSURER. HE IS PAYING 30 PERCENT MORE FOR AN 80 PERCENT REDUCTION IN COVERAGE.

IN NEW HAMPSHIRE JUST LAST MONTH, 400 RESTAURANTS AND LOUNGES PARTICIPATED IN AN "UNHAPPY HOUR" TO PUBLICIZE THE IMPACT THAT LIQUOR LIABILITY COSTS ARE HAVING ON THEIR BUSINESSES. PARTICIPANTS IN THE "UNHAPPY HOUR" RAISED THEIR PRICES TO REFLECT THEIR LIABILITY PREMIUM INCREASES. AT ONE RESTAURANT, A BOTTLE OF BEER COST $14.25 AND A SNIFTER OF BRANDY COST $40.

ALTHOUGH THIS EVENT WAS STAGED TO RAISE AWARENESS OF THE LIABILITY INSURANCE PROBLEM, IT GRAPHICALLY UNDERSCORES WHAT CONSUMERS CAN EXPECT UNLESS THIS PROBLLEM IS IS ADDRESSED QUICKLY AND EFFECTIVELY. ALREADY PREMIUM INCREASES ACCOUNT FOR AS MUCH AS 30 PERCENT OF THE PRICE OF SOME PRODUCTS, WHILE OTHER PRODUCTS OR SERVICES HAVE BEEN COMPLETELY WITHDRAWN FROM THE MARKETPLACE.

AS A BUSINESS ASSOCIATION, SBSB WAS FORCED TO ELIMINATE ITS TELEX SUBSCRIBER SERVICE FOR OUR MEMBERS BECAUSE WE COULD NOT OBTAIN ERRORS AND OMISSIONS LIABILITY INSURANCE AT ANY PRICE.

IT IS CLEAR THAT THE INNOVATIVE STRENGTH OF OUR ECONOMY IS BEING SAPPED BECAUSE OF THIS CRISIS.

THE QUALITY OF VITAL SERVICES SUCH AS HEALTH CARE IS ALSO BEING THREATENED. MANY DOCTORS PRACTICING HIGH-RISK SPECIALTIES SUCH AS SURGEONS, OBSTETRICIANS AND ORTHOPEDISTS ARE WALKING AWAY FROM THEIR PRACTICES DUE TO THE FLURRY OF MALPRACTICE SUITS AND GIANT PREMIUM HIKES. A PENNSYLVANIA SBSB MEMBER WHO IS A GENERAL PRACTITIONER COMPLAINED THAT 30 TO 40 PERCENT OF HIS INCOME IS BEING SWALLOWED UP BY MALPRACTICE INSURANCE PREMIUMS. SBSB CONSTANTLY HEARS THE FRUSTRATION AND ANGER OF OUR MEMBERS WHEN THEY SEE THEIR HEALTH CARE COSTS RISE AGAIN AND AGAIN, DUE IN PART TO DOCTOR'S DEFENSIVE MEDICINE AND THE SEEMINGLY ENDLESS UPWARD SPIRAL OF MALPRACTICE RATES.

THERE ARE ALSO MANY OTHER SELF-EMPLOYED PROFESSIONALS SUCH AS ACCOUNTANTS, ENGINEERS AND ARCHITECTS WHO ARE FINDING THEMSELVES VULNERABLE BECAUSE THEY LACK THE RESOURCES THAT LARGE COMPANIES HAVE TO PROTECT THEMSELVES FROM THIS TIDAL WAVE OF LITIGATION.

WHILE BIG COMPANIES AND THE INSURANCE INDUSTRY MANEUVER TO PROTECT THEMSELVES FROM THE DELUGE OF CLAIMS AND LAWSUITS, SMALL BUSINESSES ARE ON THEIR OWN. SOME SMALL BUSINESSES HAVE HAD THEIR POLICIES CANCELLED WITH NO ADVANCE NOTICE FROM THE INSURER, AND OTHERS FIND THAT EVEN IF THEY CAN OBTAIN COVERAGE, THEY CAN'T GET ADEQUATE PROTECTION.

LARGE CORPORATIONS CAN POOL THEIR RESOURCES AND SELF-INSURE, BUT SMALL BUSINESSES OFTEN HAVE NO CHOICE. IN ORDER TO OBTAIN A LIABILITY POLICY, MANY SMALL BUSINESSES ARE FORCED TO SWITCH ALL THEIR INSURANCE FROM ONE CARRIER TO ANOTHER. NOT ONLY ARE THEY BEING GOUGED BY EXORBITANT LIABILITY PREMIUMS, BUT THEY ARE DENIED THE FREEDOM TO SHOP FOR THE MOST COMPETITIVE PRICE FOR THEIR OTHER INSURANCE NEEDS.

ADDITIONALLY, MANY INSURANCE CARRIERS WILL NOW ONLY WRITE POLICIES WHICH WILL PAY "CLAIMS MADE" DURING THE POLICY PERIOD. THIS LEAVES MANY BUSINESSES EXPOSED TO A LONG TRAIL OF LIABILITY. A MACHINERY MANUFACTURER CAN BE SUED FOR AN ACCIDENT CAUSED BY EQUIPMENT MADE 20 YEARS AGO THAT MAY HAVE BEEN ALTERED OR POORLY MAINTAINED. UNLESS YOU CAN PRODUCE A PRODUCT WHICH YOU ARE WILLING TO GUARANTEE FOREVER AGAINST MISUSE, POOR MAINTENANCE OR CONSUMER STUPIDITY, YOU BETTER HAVE A LOT OF MONEY SET ASIDE TO PAY FOR LAWSUITS.

WHEN A LARGE CORPORATION LOSES A LIABILITY LAWSUIT, THE AWARD IS PAID OUT OF THE CORPORATION'S ASSETS. THE PERSONAL ASSETS OF THE OWNERS AND OFFICERS ARE PROTECTED. THIS DOES NOT HOLD TRUE FOR A SMALL BUSINESS, WHERE OFTEN CORPORATE AND PERSONAL ASSETS ARE ONE AND THE SAME. MANY SMALL BUSINESSES SECURE LOANS WITH THEIR HOMES, AND OTHER MAJOR PERSONAL POSSESSIONS. A SINGLE LIABILITY LAWSUIT CAN WIPE THEM OUT.

IRONICALLY, A LARGE PORTION OF THE BLAME FOR THIS SORRY STATE OF AFFAIRS CAN BE PLACED SQUARELY ON THE SHOULDERS OF THE INSURANCE INDUSTRY ITSELF. DURING THE LATE 1970'S, WHEN INTEREST RATES WERE HIGH, SOME GREEDY INSURANCE COMPANIES ENGAGED IN CASH-FLOW UNDERWRITING, SLASHING PREMIUMS TO EXPAND THEIR SHARE OF THE MARKET, RESULTING IN RATES WHICH WERE TOO LOW TO COVER THEIR RISKS.

AS INTEREST RATES DECLINED AND CLAIMS INCREASED, THE INSURANCE INDUSTRY HAS REACTED BY PURSUING AN ANTI-UNDERWRITING POLICY. ENTIRE LINES HAVE BEEN CANCELLED OR REFUSED RENEWAL. BLANKET PREMIUM HIKES FAIL TO DISTINGUISH BETWEEN GOOD AND BAD RISKS. THE INSISTENCE OF CARRIERS IN OFFERING STRICTLY CLAIMS-MADE POLICIES IS JUSTIFIED ON THE DUBIOUS PREMISE THAT CERTAIN UNPREDICTABLE RISKS CANNOT BE SEPARATED FROM ROUTINE RISKS.

THE INSURANCE INDUSTRY TODAY IS NOT FULFILLING ITS FUNDAMENTAL FUNCTION IN THE MARKETPLACE. WHEN THEY FAIL TO DISTINGUISH BETWEEN DIFFERING RISKS, THEY ARE NOT TRULY UNDERWRITING, AND UNLESS THEY SPREAD APPROPRIATE RISKS, THEY ARE NOT TRULY PROTECTING THEIR RESERVES.

WHEN THE INSURANCE INDUSTRY FAILS TO ACT RESPONSIBLY AND POLICE ITSELF, THEN OTHER ALTERNATIVES MUST BE CONSIDERED. PARAMETERS FOR REGULATION SHOULD BE ESTABLISHED AT THE STATE LEVEL, SO THE INSURANCE COMPANIES ARE NOT ALLOWED TO REPEAT THIS FIASCO.

THE LEGAL SYSTEM HAS ALSO EXACERBATED THE PROBLEM. THE TORT SYSTEM IS TOTALLY DEVOID OF ANY CONSISTENT, PREDICTABLE STANDARDS. THE RESULT IS A PATCHWORK OF CONFUSING AND CONFLICTING STATE LAWS WHICH SPAWN LAWSUITS, RAISE INSURANCE PREMIUMS, AND INCREASE CONSUMER PRICES. LIABILITY LAWYERS EXPLOIT THIS SITUATION, SHOPPING AROUND TO PURSUE CASES IN THOSE STATES WHERE THEY CAN WIN THE HIGHEST AWARDS AND LINE THEIR POCKETS WITH FAT CONTINGENCY FEES.

THE LEGAL SYSTEM IS ALSO EXPENSIVE AND TIME-CONSUMING, SPENDING NEARLY $3 IN LEGAL AND ADMINISTRATIVE FEES FOR EVERY $1 AWARDED TO PLAINTIFFS.

ADDITIONALLY, THERE IS THE MISCONCEPTION ON THE PART OF JURIES AND THE GENERAL PUBLIC THAT NO ONE IS HURT BY BIG DAMAGE AWARDS BECAUSE INSURANCE COMPANIES ARE FOOTING THE BILL. JURY AWARDS IN LIABILITY CASES ARE OFTEN PREDICATED ON THE ABILITY OF THE DEFENDANT TO PAY, NOT ON WRONGDOING. WHILE IT MAY APPEAR TO A JURY THAT A DEFENDANT WITH "DEEP POCKETS" IS PAYING THE CLAIM, THE TRUTH IS THAT THE MONEY IS COMING OUT OF MILLIONS OF "LITTLE POCKETS" IN THE FORM OF HIGHER PRICES AND HIGHER PREMIUMS.

SMALL BUSINESS SERVICE BUREAU BELIEVES THAT A MULTI-FACETED APPROACH IS NEEDED. MANY PARTIAL STOP-GAP MEASURES HAVE BEEN IMPLEMENTED TO DATE. THE SLIDING SCALE LIMITS ON LAWYER'S FEES IN CALIFORNIA HAS BEEN UPHELD IN THE COURTS. BILLS FILED IN MANY STATES SEEK TO LIMIT NON-ECONOMIC AWARDS OR TO FURTHER RESTRICT THE DEFINITION OF "REASONABLE DOUBT" AND LIABILITY ITSELF.

THE HOUSE COMMITTEE ON SMALL BUSINESS SHOULD CONSIDER THE FOLLOWING FOR STATE ACTION:

1. LAWS AND REGULATIONS THAT LIMIT OR PREVENT CANCELLATION OF LIABILITY POLICIES WITHIN THE POLICY PERIOD;

2. ADVANCE NOTICE OF 90 DAYS SHOULD BE REQUIRED IN ANY INSTANCE WHERE AN INSURER WILL NOT RENEW A POLICY;

3. UNIFORMITY OF "CLAIMS OCCURED" APPLICATION SHOULD BE ACHIEVED TO PREVENT AN UNFUNDED LIABILITY PROBLEM AS IS POTENTIAL THROUGH "CLAIMS MADE" POLICIES;

4. SBA AND COMMERCE DEPARTMENT OFFICES SHOULD ASSIST INDIVIDUAL BUSINESS OWNERS THAT ARE UNABLE TO PURCHASE LIABILITY COVERAGE. THE "800" LINE COULD BE EXPANDED TO INCLUDE INFORMATION WHICH COULD REFER INSUREDS TO LOCAL CARRIERS STILL WRITING COVERAGE;

could be

5. A UNIFORM PRODUCT LIABILITY STATUTE ON A FEDERAL LEVEL SHOULD BE IMPLEMENTED;

6. JUDICIAL REFORM OF THE DEPTH AND EXTENT OF LIABILITY AND CLAIMS LIMITATION MUST BE ACHIEVED. OUR LAWS CANNOT BE AN EXCUSE FOR MISUSE OF PRODUCTS, THEY SHOULD PROVIDE ONLY THE PROTECTION AND RESTITUTION THAT IS APPROPRIATE, NOT SIMPLY WHAT IS AVAILABLE;

7. A SYSTEMATIZED LIMIT ON ATTORNEY'S CONTINGENCY FEES MUST BE ENACTED IN EACH STATE;

8. NON-ECONOMIC AWARDS SHOULD HAVE A MAXIMUM LEVEL;

9. PUNITIVE DAMAGES SHOULD BE APPLIED ONLY IN CASES WHEN WRONGDOING IS TRULY "BEYOND A REASONABLE DOUBT".

U.S. SENATOR DANFORTH'S BILL, S.1999, CONTAINS SEVERAL CONTRUCTIVE REFORMS THAT CAN BE USED IN THIS EFFORT:

10. A MORE ACCURATE DEFINITION OF WHAT CONSTITUTES LIABILITY;

11. DISINCENTIVES FOR THE PURSUIT OF FRIVOLOUS LAWSUITS, INCLUDING FINES AND PAYMENT OF THE DEFENDANT'S LEGAL FEES BY THE CLAIMAINT WHEN A LAWSUIT IS DETERMINED TO BE WITHOUT MERIT;

12. LIMITATION ON THE LENGTH OF TIME A BUSINESS OR INDIVIDUAL MAY BE HELD LIABLE FOR HARM TO A CLAIMANT;

13. REMOVAL OF A JURY FROM THE AWARDS PROCESS, IN FAVOR OF JUDGES WHO POSSESS THE EXPERIENCE AND EXPERTISE TO RENDER AN EQUITABLE AND REASONABLE DECISION;

14. RESTRICTION OF PUNITIVE AND NON-ECONOMIC DAMAGES.

15. "JOINT AND SEVERAL LIABILITY" MUST BE DEFINED IN A MORE RESTRICTIVE MANNER.

I RESPECTFULLY URGE THE MEMBERS OF THIS COMMITTEE TO REVIEW S.1999 AND TO SUPPORT S.100 AS IMPORTANT INITIAL STEPS TO RESOLVING THE LIABILITY CRISIS.

WITH GREAT DIFFICULTY AMERICAN SMALL BUSINESSES HAVE SURVIVED THE HIGH INFLATION AND HIGH INTEREST RATES OF THE SEVENTIES. NOW THEY ARE BEING ASKED TO OVERCOME THE SINGLE MOST DESTRUCTIVE PROBLEM SINCE THE GREAT DEPRESSION. UNLESS THERE IS ADEQUATE INTERVENTION ON THEIR BEHALF TO SOLVE THE LIABILITY INSURANCE CRISIS, SMALL BUSINESSES WILL CONTINUE TO MEET INCREASING DISASTER EACH DAY. IT'S ALREADY A UNIVERSAL THREAT TO THE WELLBEING OF EACH AND EVERY SMALL FIRM IN AMERICA. AND AS THIS SECTOR OF THE ECONOMY SINKS, SO WILL OUR ECONOMIC RECOVERY. I URGE YOU TO ACT QUICKLY AND DECISIVELY TO PREVENT ANY FURTHER DAMAGE TO SMALL BUSINESS. LET'S KEEP THE DRIVING FORCE BEHIND THE AMERICAN ECONOMY IN TOP RUNNING CONDITION. THANK YOU.

Mr. MAVROULES. Thank you very much, Mr. Doyle.
Let me see if I say this right now. John. Mr. Rathgeber.
Mr. RATHGEBER. Excellent.
Mr. MAVROULES. Excellent. Why don't you proceed then?

TESTIMONY OF JOHN RATHGEBER, SENIOR VICE PRESIDENT AND COUNCIL CHAIRMAN, CONNECTICUT BUSINESS INDUSTRY ASSOCIATION

Mr. RATHGEBER. For the record, my name is John Rathgeber, and I am senior vice president and chairman of the council for the Connecticut Business Industry Association.

CBIA is a statewide trade association with 6,300 member companies in Connecticut with about 700,000 employees. The overwhelming majority of our membership is small business, and the overwhelming majority of our membership are consumers of insurance products. Therefore, my statements today are based on people who need coverage in order to do business.

We did a recent membership poll back in October and tested among our membership those issues which were of great concern, and the insurance availability question came out as the clear No. 1 concern of the business community in the State of Connecticut.

Just for your information, some of the items which are most concerned included environmental risk insurance, directors and officers liability insurance, product liability insurance, and umbrella insurance, as the key areas where the problems are being had particularly by our small business members.

CBIA has been serving and has served on the Governor's task force looking at insurance costs and availability, and on the law review subcommittee, and from that background and coupled with our own experiences in the association, we feel that the insurance companies can take care of their own problems.

I think Peter Gillies indicated that the insurance companies can price their products at a higher rate. We have heard about the new contract forms, claims made, and other types of forms that are forthcoming, and, finally, the insurance companies can improve their ability to write exclusionary language so they do not adopt those extra risks which they cannot predict.

But as consumers we need insurance coverage, and we are the people, we are the entities which are going to be left without the ability to spread our risk unless something is done with what we believe, in particular, the tort system and restoring balance to the tort system.

CBIA has been working with 40 other groups in the State of Connecticut, and there are fairly diverse numbers of organizations, the National Federation of Independent Business People, Easter Seals, Connecticut Conference of Municipalities, and all of those groups have different ideas on how to regulate insurance companies, but they also believe that it is essential that we look at the tort system and restore some balance to the tort system and, quite frankly, at this point, we have been concentrating on State law. As Peter indicated, there are activities like this going on in all 50 States, but we do believe that there is a role for the Federal Government in certain aspects, and I will get to those in a minute.

It may have also been suggested that you can deal with it as far as insurance pricing and regulatory problems, but I can tell you as an association which runs its own mutual insurance company for workers compensation, that we would not touch general liability insurance as a pool because there is no way that we could deal with the problem of trying to assess what our risks are in a marketplace which is changing so radically on a daily basis and where you had such a growth in both the numbers and the severity of lawsuits.

In our small business members and from the people on our small business advisory group, they have come to us in the past and asked us whether or not we would be willing to put together a mutual or a pool dealing with products' liability, directors' and offices' liability, or some other type of a liability program and, quite frankly, we cannot afford to do it. We can do it in workers' comp where the rules are pretty stable, at least there are limits on the liability. I should not say the rules are stable because we are always finding new claims and new bases for actions, but——

Mr. MCKINNEY. Excuse me just a minute for interrupting you, John.

Do we not have a special State unit, too, that looks at unemployment and all these problems?

Mr. RATHGEBER. Workers' comp, yes.

Mr. MCKINNEY. Workers' comp?

Mr. RATHGEBER. Workers' comp. These are, of course, the workers' comp commissioners looking at the system, and you have a statutory plan for defining both your areas of liability and also your limits of liability and, therefore, we are able to provide a pool for our smaller, in this case, metal working companies for workers comp. We could not do so in many other areas of potential liability.

What do we think are essential as far as tort reform? Well, I think Commissioner Gillies indicated joint and several liability is certainly high on anyone's litany of things that must be addressed, and we think that is credibly important if you are going to get back to some predictability.

In the State of Connecticut, I can tell you that you can be a tort feasor who is 10 percent responsible for an injury, held 100 percent responsible for the damages, and have no cause of action against your fellow tort feasor even if they are solvent, because we do not, in Connecticut, recognize the right of contributions and we do have a pure joint and several liability system.

The commission which I served on for the Governor talked about a modified joint and several liability system, and we have also had before us in the Connecticut Legislature a bill going to a pure several liability system.

On product liability, which is obviously a major concern to our membership, Connecticut did pass a law back in 1979 on product liability, and it makes fault as a basis of assessing damages, but it works in the framework of two things, and I think this is one of the reasons we are still having problems.

One is that it works in the framework of joint and several liability, so that, again, a minor tort feasor, a deep pocket tort feasor may be held solely responsible for 100 percent of the damages. Two, you are in a product area. You are dealing with the situation

which interstate commerce is involved, and there is the potential for foreign traffic.

Even if Connecticut has the best products bill in the country, Connecticut manufacturers are selling in the national markets and, therefore, exposed in other areas. I think that is one of the reasons why that area particularly needs Federal attention.

The third problem in Connecticut's own product liability bill is one which is incorporated in the statutory language, and that is that we adopted back in 1979 what is called pure comparative negligence. You can be 80-percent responsible for your own injury in the use of a product and sue the product manufacturer for 20 percent of the damages. That certainly does not encourage the State handling the products and does, of course, increase the potential for litigation.

Most Connecticut law, by the way, is modified comparative negligence, where, if you are more than 50-percent responsible for your own accident, you have no basis of filing a claim or a court action.

And, the other item which I would just mention since it has been brought up here a couple of times is on directors and offices and nonprofit organizations.

Many of our company members and I, myself, serve on a number of voluntary boards of directors, and it is a major problem. The Connecticut bill which is presently before our judiciary committee would set up a separate standard for voluntary directors and officers of nonprofit organizations, and that would be one of willful want and malicious activities rather than simple negligence, and that would be helpful in that framework.

Again, however, I think you do need to address these other issues, including joint and several liability, in particular. There are a number of other items that I know both Congressmen have asked questions about on the $100,000 cap. We have looked at caps in the State of Connecticut.

The Commissioner indicated the concern about constitutionality. That is a concern dealing with Connecticut's unique State constitution as opposed to Federal constitution, and we have also looked at contingency fees and some type of a sliding scale on contingency fees, so as to reduce the size of award that has to be forthcoming to the plaintiff in order to not only fully compensate the plaintiff, but then also compensate the attorneys.

Mr. MAVROULES. Very good. Thank you very much.

Stew, I can commend all the witnesses here this morning. They are giving great testimony.

Mr. MCKINNEY. Answering most of my questions.

Mr. MAVROULES. Same here.

Now, we are going to get the other side of the story, I believe. Mr. Chittenden, the American Insurance Association.

Tom, if you would proceed.

TESTIMONY OF THOMAS S. CHITTENDEN, SENIOR VICE PRESIDENT AND GENERAL COUNSEL, AMERICAN INSURANCE ASSOCIATION

Mr. CHITTENDEN. Thank you very much.

My name is Tom Chittenden. I am senior vice-president and general counsel of the American Insurance Association. AIA is an organization which nationally has approximately 180 member companies that write collectively approximately 40 percent of the commercial insurance in this country. So, we clearly have an interest in this crisis and solutions to it.

I would like to try to capsule for you what I think is emerging as the perspective of the major primary writers of insurance on this problem, and that is that while the industry is certainly not perfect and there are lots of things that we can and should be doing to help out this crisis, so-called, in the short run, the problem is not going to be solved unless and until society as a whole looks at the underlying tort liability system which has expanded and become less and less predictable from a funding point of view to the point where insurance is problematical in the future.

I think that one of the most telling comments I have heard this morning is from the representative of Connecticut's business community to the effect that there is no way on a group self-insurance basis that his organization would get into the liability business these days. That, in and of itself, takes this problem beyond the established commercial insurance industry.

Let me very briefly talk about a number of things that the industry and particularly my association is doing on a national basis to alleviate the problems in the short run.

We and our companies are involved in some 35 market assistance programs nationwide. One of which was alluded to here in Connecticut by Commissioner Gillies. These are pure and simple voluntary efforts to encourage companies to write difficult-to-place risks.

It is working better in some lines than in others. For example, there has been great progress with respect to day care liability on a national basis. I think, in part, this is because the extreme liability system problems are not as present in day care as in some other lines.

But, nationally, these maps are looking at liquor liability, some general liability, a whole variety of exposures, and while they have certainly not solved the problem, they have made markets more efficient. They have made companies look at underwriting. They have provided frankly some opportunities on the part of commissioners to jawbone the industry to stretch a little bit to write in this very difficult climate.

We are also participating with the National Association of Insurance Commissioners in a clearinghouse, which is designed to identify and make available privately to insurance commissioners companies that may be willing to write difficult lines. This would include surplus lines companies, by the way, as well as admitted companies, and that activity, I think, will have some beneficial effect as it gets off the ground.

Finally, the American Insurance Association has promulgated for legislators and commissioners model cancellation and nonrenewal regulations, which admit that there is some responsibility on the part of the insurance industry not to arbitrarily cancel midterm and to provide reasonable notice of nonrenewal, and many legislators are looking at that provision at this time.

But, I come back to the underlying system. You know from other testimony and other conversations and, indeed, from testimony this morning that the industry was highly competitive during the early 1980's, and as it turned out, underpriced many of the risks that it wrote, and in early 1985, there was a reaction to the emerging losses that were becoming more and more apparent, largely led by reinsurers, both domestic and foreign, who had begun to realize that the American market was providing a very disproportionate share of the losses that they were experiencing on a worldwide basis.

I think the social attitude that has been driving the production of the losses and the expansion of the system is basically: "Let us compensate everybody for everything." Insurance is in this view, an absolutely limitless pool of money, and it will always be there, and there may be some cycles that drive prices up and down to some degree, but we can do anything with respect to the frequency and severity of losses and somehow this wonderful worldwide distribution system will be able to take up the slack.

One of the things, from our point of view, that is beneficial to this crisis is that I think, in large measure, that view of the world is being laid to rest. The worldwide insurance system is a very resilient mechanism, but it is not limitless. It can be broken. It can have problems. In the long run, it can be destroyed by a very costly and rapidly expanding system that just cannot be funded.

Let me just give you a couple of examples of the kinds of decisions that underwriters have great difficulty with in the insurance business, and you have to understand that underwriters and their managing directors have to predict the future. They have to look at past experience, but they have somehow, in this very difficult context, to figure out what they will be facing from 1 year to 25 or 30 years into the future, depending on the characteristics of the particular risk.

In some States, in product liability, the so-called state of the art defense has been limited or abolished. Basically, that means absolute liability on the part of the manufacturer regardless of technical standards or what he should have known or could have known about particular products and the risks they might entail. That is not universal, but that has occurred in several States. It is a wide open door kind of thing, and it, frankly, from an underwriter's point of view, makes it impossible, particularly if you lay joint and several liability on top. It makes it impossible to have any notion whatsoever what the costs of insuring that risk will be when everything comes home to roost.

There is a widening use of statistical proof or presumptions to establish causation in certain product liability lines and in the environmental area. If causation is difficult to prove scientifically or epidemiologically, why not dispense with the necessity of proving causation? Again, this opens the system so broadly that there is no way of predicting what the losses might be when they finally come in.

There are a series of decisions on various grounds that expand individual responsibility, mainly of corporate defendants, to class responsibility for product liability. These go under such monikers as enterprise or market share liability or conscious parallelism.

The core notion, again, riding on joint and several liability or expanding on it is that, if you cannot really determine whose product caused the loss, better to bring in the whole group that insurers are writing during that time period and make sure that the losses are distributed over that entire group. So the alternative of not allowing compensation to a class of plaintiffs is not tolerable.

I am not commenting on the validity or not of these very broad notions as a matter of social policy. I am indicating that these decisions cause enormous difficulty in insurance markets.

I would argue that beyond the problems that insurance companies are having with the liability system, as a matter of social policy, we have to look at the system broadly to see how fair it is, how efficient it is, in getting compensation to injured parties or in deterring the kind of conduct that one wants to deter.

The Institute for Civil Justice recently did a survey of asbestos cases, and this is a rather famous statistic by now, that I believe indicated that of every dollar necessary to fund that system, only 37 cents ended up actually compensating injured persons suffering from asbestosis and the like. The balance, which is 63 cents, if my arithmetic is correct, largely went to lawyers on both sides of the bargain.

That, gentlemen, is an absolutely intolerable ratio, it seems to me, for any system that is trying to compensate people with any degree of fairness or efficiency.

There is another study by ICJ out of the Cook County court that indicates that absolutely similarly situated plaintiffs, to the best that fine research can group, recover far more from either units of government or corporate defendants than from individuals. This is some proof that there is, in fact, a deep pocket effect in this system.

I believe, and I can provide to the subcommittee later all of the statistics and studies, if you like.

Mr. MAVROULES. We would like that, if you would.

Mr. CHITTENDEN. All right. I believe that the ratio of individual to corporate award is something like one to five. I would not be held exactly to that, but it is in that range.

Many people never get into this system for one reason or another. Other people are arguably overcompensated by it. Always, there are severe delays because of the way the court system works, and the way our settlement processes work in getting compensation to injured victims.

So, beyond the problems with the insurance mechanism, which is severe, I would submit that there are many problems that reside in this system that, sooner or later, will require a broad look at it.

I am conscious of the time. I have some materials here, testimony on the Danforth bill, and the insurance services office publication with industry statistics and analyses, an industry white paper on the crisis.

I can make all these available now or later.

Mr. MAVROULES. Very good. Without objection, we will include that as part of the record.

Mr. CHITTENDEN. That is all I think I would like to say at this point.

[See app., p. 91.]

Mr. MAVROULES. Well, thank you very much, all of you. That was excellent testimony. We will be getting other diverse views, I am sure, as the hearing goes on.

I am just going to ask one question here because the more I listen to you, I see that all of you are working on the problem in your own way.

What role, and at what period of time, should the Federal Government be involved in regulations regarding this particular problem? The more I listen to the testimony here this morning, the more I am convinced that maybe the Federal Government should keep its hands off of it. Should we be regulating it and to what degree?

Do all three of you want to take a shot at that?

Mr. RATHGEBER. I would suggest that the time is now for at least selective involvement by the Federal Government in areas such as product liability law, which is clearly affected because it is involved in interstate commerce, and the other area would be to review the Federal statutes which impose joint and several liability and to deal with those issues because, in that area, it is Federal statutory law which is on top of the problems within the State court system.

Mr. DOYLE. I think there are probably two areas in addition to that, Mr. Chairman.

One would be the idea, again that I referenced, the uniform product liability standard that had been considered before Congress. The other is something that was done by the Federal Government for a period of a few years, I believe, during the 1960's, which was Federal reinsurance, not Federal intervention in the marketplace, but a temporary second step, if you will, or reinsuror of last resort in a sense, that was done during a period of high insurance risks during the 1960's to address the problem from a temporary point of view.

I do know that insurance is regulated on a State level, but, again, through interstate commerce and a uniform standard, I believe Federal action could be taken.

Mr. MAVROULES. Tom.

Mr. CHITTENDEN. The AIA has been, for a long time, in favor of Federal regulation of product liability. We were early and vigorous supporters of Senate 100, the Kasten bill, working with a broad business coalition.

We have some concerns with Danforth in terms of retroactivity and the degree to which the limit of a first-tier system would be so broad as to actually make insurance less affordable for small businesses than the current system, ironically.

Since we have problems with that approach, we are working very closely with committee staff on both of those measures.

On Federal reinsurance, my only comment would be if the fundamentals are not modified, government reinsurance merely opens, in this case, the Federal fist to the kind of invasion that the group self-insurors and insurance companies have been subject to. It is not a solution. It has to be very carefully drafted.

Unfortunately, these things thought once to be temporary, end up being permanent, and there are great risks.

Mr. MAVROULES. Stewart?

Mr. MCKINNEY. I sometimes sit here with a twinge realizing that it was the dean of my alma mater law school who dreamt up deep pockets, but the problem I have with deep pockets is that the deepest one of all is ours.

Last night on CBS, they said that 30 percent of the medical bills of the United States was protective medicine, in other words, for insurance.

Now if you add this 30 percent of the Medicare/Medicaid bill and you take the fact that we are already paying to the doctors malpractice insurance through our fees, it is a mindboggling figure, and then Mr. Mavroules, you and I are struggling to save the Small Business Administration from the impact of this present administration's desire to end it all. If we are, on one hand, going to give the Federal money to the small business associations to keep it alive, and to the Small Business Administration to keep it alive, progressive, and to keep it going, what is it then costing us not to have insurance for small businesses or have their insurance canceled?

Let us look at another cost factor. Would any of you gentlemen like to figure out what part of the cost of a product is insurance in today's market?

Mr. CHITTENDEN. I am really incapable of answering that. I do not know.

Mr. RATHGEBER. I think it partly depends on the product.

Mr. MAVROULES. Let us take liquor.

Mr. RATHGEBER. As I understand it, we do not have any liquor companies in the State of Connecticut. Heublein was here, but I understand the beer wholesalers in the State of Connecticut this year had their first price increase in 4 or 5 years, and it was directly affected by their liability insurance.

I think no matter where you go—I know my son's own swimming school, we get an apology in the letter saying that we are sorry we are having a 30-percent increase but it is reflective of our increased insurance costs, and it is clearly affecting the products that people are purchasing and the services which we have come to rely on.

I do think that it varies with the type of product. Clearly, things which are involved with hazardous materials and——

Mr. MCKINNEY. John, a taxicab ride in Stamford, CT, can be a hazardous experience, and I am assuming those cabs are charging rates that supposedly compensate them for that also.

Mr. DOYLE. I know that some of our members in New Hampshire had an unhappy hour where they increased the prices of their drinks in proportion to their premiums, and they were charging $40 for a brandy. That does not tell you the percent of the cost of the product, but it does tell you the degree of the problem.

Mr. MCKINNEY. I am one of the few nonlawyers in Congress and I was looking at my old business, which included lying out on I-95, changing truck tires. I doubt if I could get insurance now.

Mr. CHITTENDEN. Well, I do not know the answer to the specific question. Doctors at least allege that with respect to some specialties, they are at the brink of unaffordability. Interestingly, much of that comes from Massachusetts. There was an article in the New York Times that you may have seen a couple of Sundays ago indicating a squeeze that impacts OBY/GYN's severely, between at-

tempts at cost containment on the gross end and severe rises coupled with retroactive assessment on the cost end, which are incredibly difficult to get over from the individual doctor point of view.

That is the best single example that I can think of in a situation that is a flat out or going toward being a flat out affordability situation which will, if continued, drastically affect the practice of medicine in Massachusetts, which, as you know, has been for 150 years one of the leading jurisdictions for medical science.

Mr. MCKINNEY. I was called by a group of doctors last night at home, one of whom is a close friend. He stated that their insurance for their three-doctor group with over 105 years of practice among them and no lawsuits was over $190,000 a year.

Mr. MAVROULES. As a matter of fact, a few months ago one of the orthopedic surgeons back in my district was looking at an insurance bill of somewhere between $80,000 to $90,000. That is an enormous amount of money, and if you recall at that time, there was a job action taken by the doctors back in Massachusetts. They brought it to the attention of the legislature and the Governor, and the Governor and the speaker of the house decided to take a hard look at it, and they are doing that right now. I just thought you might like to know that.

Mr. MCKINNEY. Well, thank you very much, gentlemen.

Mr. MAVROULES. Thank you, gentlemen, very much.

OK. Our third panel. Don Edwards, N. Donald Edwards Co., Motivational Marketing in Stamford, CT; Spencer Hitch, division manager, Greater Norwalk Chamber of Commerce; and Charles Spadone, Spadone Machine Co., Norwalk, CT.

Gentlemen? Welcome and good morning.

I think we can start off with Don Edwards. Another Don Edwards is on trial this morning down in Louisiana, did you know that?

Mr. EDWARDS. Thank goodness it is Louisiana.

Mr. MAVROULES. Good morning, gentlemen.

Would you begin, Mr. Edwards, please?

TESTIMONY OF DON EDWARDS, N. DON EDWARDS CO., MOTIVATIONAL MARKETING, STAMFORD, CT

Mr. EDWARDS. First of all, I would like to commend you for bringing this hearing to Stamford. I am a small business person, and have been for the past 24 years, and I am here representing the Specialty Advertising Association International.

We are a trade association, in a technical sense, of distributor wholesalers as well as manufacturers, and I would like to read, if I may, this statement as it relates to product liability.

The Specialty Advertising Association International is a national trade association whose 3,500 members manufacture or sell specialty advertising products. Specialty advertising is an advertising medium in which useful items, such as a ballpoint pen or a calendar, are imprinted with an advertising message and distributed without charge for advertising purposes.

Annual sales for specialty advertising products exceed $3.5 billion. Manufacturers and distributors of specialty advertising products have become increasingly concerned about product liability ex-

posure, rapidly rising insurance costs and the existence of many different product liability laws at the State level.

Such manufacturers and product sellers that are engaged in interstate commerce face great uncertainty about their potential exposure to claims for damages because of the lack of uniformity of State product liability laws.

Many States have moved from the doctrine of negligence to strict liability, and other even more far-reaching theories of liability, and many State manufacturers that have exercised all due care in placing their products in the stream of commerce may still face liability merely because they manufactured a product.

The lack of uniformity in product liability law has meant that manufacturers can never be certain even if they have used reasonable care that they will not face liability any time the product user is injured, even when the product is misused or altered.

The present situation is, therefore, grossly unfair and results in increased costs for specialty advertising.

In summation, the Specialty Advertising Association International, a trade association of wholesale distributors, believes that the current product liability crisis is caused and maintained by an unstable, unpredictable product liability tort system made up of 51 different confusing, conflicting, and frequently changing sets of product liability laws.

It is an interstate problem requiring a clear, uniform Federal law enabling manufacturers, sellers, and users of products to know their rights and responsibilities. Such a law would also help insurors to objectively and accurately assess risks and to stabilize the insurance market.

Present law is particularly unfair to distributors of specialty advertising products. Such firms place orders for products from manufacturers, and, thereafter, the products ordered are drop-shipped directly to the buyer or user of specialty advertising.

In other words, the distributors usually never even see the products they sell. Yet, distributors are sellers under the doctrine of strict liability and they can be held liable if the product proves to be defective so as to be unreasonably dangerous to users.

We, therefore, strongly support provisions in Senate 1999 that would ensure that the distributors in our industry and other middle men in the sales distribution chain will be protected from this unjust threat of liability.

We also support the concept of a Federal bill, and we commend Senator Danforth for his efforts to cause such legislation to be enacted.

I would like to refer to three particular court cases that impact and have impact on the wholesale distributor responsibility. As a direct consequence of the relatively new legal doctrine of strict liability, the non-negligent wholesaler-distributors are now routinely made parties to product liability claims and suits. Section 402A of the restatement of torts which sets forth the doctrine states that all sellers are strictly liable and seller includes a wholesale distributor.

The court cases in agreement are, just as an example, *Dunham v. Vaughn and Bushnell Manufacturing,* an Illinois Supreme Court 1969. The court held a wholesaler-distributor is strictly liable for a

defective hammer which passed through this warehouse unopened in its original package. In fact, the doctrine of strict liability has even been applied to wholesaler-distributors who sell the product but never have physical possession of the merchandise which was directly shipped from the manufacturer to the customer.

This was the result in *Little* v. *Maxam, Inc.*, in the North Dakota court, where a distributor had a machine shipped directly to his customer and took no part in its design, construction, or installation and yet was liable.

In the California case, *Canifax* v. *Hercules Powder,* in the California Appellate Court in 1965, the court held a wholesaler-distributor of a dynamite fuse strictly liable even though the wholesale distributor never had possession of the fuse, having passed on the customer's order to the manufacturer who shipped directly to the customer.

These are but a few examples of the reported product liability cases which involve wholesaler-distributor.

Mr. MCKINNEY. Mr. Chairman, our previous witness will probably hide his light under a mushroom because that is the way he normally does it, but last year he was Stamford Small Business Man of the Year from the Stamford Area Chamber of Commerce, and this year, he has been elected to the Small Business Conference at the White House.

Mr. MAVROULES. We are delighted to have him.

Mr. MCKINNEY. I figured I would embarrass him before his testimony and after his testimony.

Mr. MAVROULES. Thank you very much for your testimony.

Mr. EDWARDS. Thank you.

Mr. MAVROULES. Mr. Hitch, if you would take a seat, please. You can proceed.

TESTIMONY OF SPENCER HITCH, DIVISION MANAGER, GREATER NORWALK CHAMBER OF COMMERCE

Mr. HITCH. Thank you.

Well, I am Spencer Hitch, division manager with the Greater Norwalk Chamber of Commerce, and I am representing the many small business members of the chamber, and we certainly welcome this opportunity to express the concerns of our small business members regarding product liability and liability insurance costs.

This hearing, which enables us to be in touch directly with you and your committee, gives us a line of communication to the Federal level, where assistance on this subject is sought by small business with great urgency today.

Many of our chamber members have given us information about their problems in this area. I know some of them are here today, and they will give you their perspective personally.

On behalf of all the chamber small business members, we would like to summarize briefly their comments and indicate their collective point of view. Norwalk has a large number of small businesses, overwhelmingly so. Many of them are long established and successful in their lines of endeavor and well positioned in their business and community relations.

Problems of product liability with skyrocketing insurance costs have come to the forefront here with disruptive speed and force. Some say they look to emergency measures at the Federal level to help them deal with these crippling costs.

On one hand, our members cite increasing vulnerability and ever-increasing numbers of civil suits, greatly increased awards, larger and more frequent punitive awards. Extension of responsibility and duration and degree of liability as well as the inconsistencies and uncertainties of the tort system. They know these are factors that are driving insurance costs up as well as impacting them personally in their own businesses. On the other hand, insurance cost increases are more and more difficult to withstand, and this leads to the threat of inadequate coverage and uncompetitive productive cost structures. Many find it hard to take that premium cost increases are not related to the experience record of the individual, and it is a fact that small businesses are at a particular disadvantage as compared with large corporations when it comes to dealing with an insurance coverage need or absorbing a large increase in an unproductive expense item component of the cost.

The specifics of these cases that lie behind the general statements are being told and retold on all sides today. Our small business members are looking for help urgently in both the short-term and the long-term sense. Some of the areas cited are: Uniform Federal standards to replace State laws; tort reform, various ways to limit or control damage awards, stricter standards to identify liability, limits on liability to proved fault or negligence, share of blame adjustments, statute of limitations, product warning standards; some call for more regulations of insurance companies and their rates; while most small businesses are opposed to more government regulations, some consider this emergency merits the expedient of short-term relief through subsidies, pooling arrangements, or damage limitations.

In any case, it is felt that careful investigation is needed of all these aspects to assess the factors and look for the answers. Also, more public scrutiny can help clarify these issues and publicize the problem in a larger social context on the national scene in the sense that awards are made by juries and the juries are the public.

Speaking for the small business contingent of the Greater Norwalk Chamber of Commerce, thanks for your attention, your comments, and your focus on this very crucial problem.

Mr. MAVROULES. Thank you very much, sir, for your testimony.

Mr. Spadone, please continue with your testimony.

TESTIMONY OF CHARLES D. SPADONE, CHAIRMAN, SPADONE MACHINE CO., NORWALK, CT

Mr. SPADONE. Thank you.

My name is Charles D. Spadone, and I am chairman of the Spadone Machine Co. in Norwalk, and my brother is co-owner and manager of the company and is the president.

Spadone Machine Co. was founded by my great-grandfather, and my brother and I are the fourth and fifth generations to own and manage it. Spadone designs and manufactures and sells custom-built production machinery, some of which is used in the fabrica-

tion of automobile and truck tires throughout the world. We directly employ 75 persons in Norwalk, CT and provide employment for an additional 100 persons in associated companies who supplement our manufacturing.

Four years ago, our insurance premiums ran about $100,000 for the package. Last year, we paid approximately $165,000, and this year, our rates have jumped to $463,000.

Mr. MCKINNEY. You make me glad I am out of the tire business.

Mr. SPADONE. It has been a hard business to service, Congressman.

The renewal date is March 31, 1986, and at this moment, we have no assurance the insurance will be continued. Needless to say, without insurance, we face an extremely serious risk consequence, and with insurance, there is a question as to whether we can meet the premium cost burden over the period of time required for legislative relief.

A recent survey indicated that large business accounts for about 34 percent of the Nation's employment. This figure clearly indicates that if 66 percent of the Nation's business is unable to find financial and risk relief now, we are about to feel a loss of job impact that will shake the country. Keep in mind this crisis is not limited to the business community. It directly affects every individual and group that requires insurance of any category as well as product liability.

The impact of product liability is out of control, and the problem is of a magnitude that demands an immediate "interim emergency act" to contain it.

My purpose today is not to debate merit, make accusations, or attempt to define content or wording of desperately needed legislation. Such must be done, but it will take time, and we do not have time. The product liability situation has exploded into a national emergency requiring immediate response to the SOS of business unable to cope with a no-win situation.

There is no time left to review, rewrite, or reform the tort and statutes of 50 States. There is no time left to write, agree upon, and effect appropriate Federal product liability controls. Millions of words are now being addressed to the issue, but unless prompt action is taken by the Federal Government, a wide segment of American business will be forced to close.

In the past, our Government has reacted to crisis by effecting temporary relief bills that phase out when correction is achieved or balance restored. It can do so in this instance, and I suggest two basic actions which would check the frenzy of litigation and which can be implemented in a short timeframe. Congress should: (a) Declare a moratorium on product liability suits now in place and during the time it takes to work out and pass a new product liability law; (b) provide interim Government product liability insurance at reasonable rates, working through the private sector.

Such insurance would be terminated and replaced by conventional private sector insurance when a corrective product liability law is in place.

That is my statement. The concern that I see is how many businesses can survive during the time that it takes to bring the lifeboats. You cannot wait 6 months, you cannot wait 12 months, you

cannot wait 18 months, because if business cannot get the insurance to begin with, it is in serious trouble, and if it can get the insurance, it may not be able to finance it.

It is that simple, gentlemen, and I thank you for asking me here today.

Mr. MCKINNEY. Charlie has been extremely interested in this. He marched in Washington for product liability, and I was, unfortunately, not in Washington when Charlie came.

Mr. MAVROULES. OK. I just want to get this straight for the record. Mr. Spadone, your insurance rates have gone up. In 1981, you paid $100,000; in 1985, you went to $165,000, now you take the big hit in 1986 of $463,000, am I correct?

Mr. SPADONE. That would be if the sales level remains about the same. That is the rate.

Mr. MAVROULES. How is your record with your insurance company?

Mr. SPADONE. I am glad you asked that, Mr. Chairman. We have been a part of this world and affected by this world and very concerned with it, from the time OSHA came on the scene, and I am going to guess that perhaps that was 8 years ago, 9 years ago, a decade ago.

Mr. MAVROULES. Probably.

Mr. SPADONE. When OSHA came to see Spadone, they said we would like to see your records, and we would like to see all the things that we have asked businesses to do, and we had bouquets. The gentleman who was there said I cannot believe it, you have absolutely gone far and beyond the line of duty.

We designed machinery and have for years with the thought of how would it stand in a court test. I have written a letter to Congressman McKinney and we pointed out that in many cases, we have guarded the machinery so drastically that I must admit to you that they have lost 50 percent of their efficiency.

How to answer you specifically is that we have also had very good advice from insurance people, and we have adhered to the letter of everything that we have been told in order to keep the——

Mr. MAVROULES. What I am trying to do, Mr. Spadone—I don't mean to interrupt you—I am trying to demonstrate that your rates have gone up by an enormous margin. Was there another reason for that? Did you have a bad record with the insurance company? Did you have a lot of injuries? Did you have other problems?

Mr. SPADONE. Over a 10-year period, we have paid claims, our insurance people have paid claims amounting to a round figure of $250,000.

Mr. MAVROULES. Over 10 years?

Mr. SPADONE. Over 10 years, and if you say that those claims were paid, certainly 50 percent and perhaps 70 percent were paid because that is the way things are handled today.

Mr. MAVROULES. OK. It is important that we get that on the record.

Mr. SPADONE. I understand.

Mr. MAVROULES. I have one other question, too.

This insurance problem, the product liability problem, what does that do to us and our small business people with reference to foreign competition?

Mr. EDWARDS. In reference to foreign competition? It creates an increased cost of doing business with the small business person, and in many cases, the affordability of insurance is virtually prohibitive and it makes the marketplace very difficult for us to compete in on a cost basis because of the insurance.

Mr. MAVROULES. So, is it a factor, in your judgment, that it takes you out of competition?

Mr. EDWARDS. Yes, it does.

Mr. MAVROULES. Many of your small businesses?

Mr. EDWARDS. Yes, it does.

Mr. MAVROULES. OK. Thank you. That is very important.

Stewart, you must have some questions, I am sure.

Mr. MCKINNEY. Well, I think it is interesting. I want to make a couple comments since I know these gentlemen.

Why did the Stamford railroad station sit for 3 weeks with nobody wearing a hard hat in the place? Because we could not get liability insurance for the engineering firms that designed the solution to what is a disaster problem.

Charlie, the bill that you are paying is just unfathomable. You have got to pass that cost on to your consumers. Are you going to stay competitive with that kind of cost?

Mr. SPADONE. The answer is no, and the answer is also that because of the type of business I am in, we custom build, I do not know how to pass that cost on to the consumers. We make individual proposals, which have competition from Holland, Germany, and Japan, and some Americans. It used to be all American. So that takes care of that.

Mr. MCKINNEY. What percentage of lawsuits that have been brought against you, I wonder, are really sort of frivolous?

Mr. SPADONE. It would be a subjective answer if I gave you the percent, but many are, and as an example, we have a suit claim now. We always have a claim, and they are typical, they cannot spell the name Spadone, they cannot identify the machine that they were hurt on, and, consequently, somebody up in the emergency room said where did it happen, well, it happened at General Tire, and what machine, no one knows and yet everybody in that area is sued under a class action suit.

This is, unfortunately, the type of world that I live in. Had I known, I would not have touched it.

Mr. MCKINNEY. Well, we have another corporation right here in Stamford, CT, that builds slicing machines. They make every safeguard known to mankind on the slicing machines, and they last for 50 years. When a worker finally gets tired of washing all the guards and putting them back on again, he slices his finger on the machine and blames the company. The company gets sued, and, in fact, their premium is now greater than their profit.

But, that affects all of us. We had a train station we could not move on for 3 weeks because we could not get insurance and, you know, with the horror stories, it is just unbelievable.

In talking to you guys, I am very serious. I am glad I went to the Congress of the United States. It is better than someone taking my

little Firestone business and telling me I am out of business, which I would be today.

Mr. SPADONE. You asked why perhaps the premium had jumped so. I think that reflects the market. There is this rush to correct——

Mr. MAVROULES. Oh, sure.

Mr. SPADONE [continuing]. And the rates are subjective, and they are ready to say well, basically, it reflects the fact they do not want to insure us.

Mr. MAVROULES. If you have got a good record and, my goodness, $250,000 paid out over 10 years is, in your type of business, and with your type of volume, certainly a good record, then why would they not want to insure you at those kinds of premiums?

Mr. SPADONE. Well, I think——

Mr. MAVROULES. I will insure you.

Mr. SPADONE [continuing]. You are reading it on every hand and you saw it in "Sixty Minutes" last night and——

Mr. MAVROULES. As a matter of fact, one of those gentlemen was from my district. Bernie Klein, Lynn, MA.

Mr. SPADONE. Yes. He can pass $4.50 a ladder, per ladder, on to the consumer. My business is not that definitive.

Mr. MAVROULES. You cannot do that?

Mr. SPADONE. No.

Mr. MCKINNEY. And, another thing that gets me is something the chairman and I mentioned. If you go to court, quote unquote, who probably suffers? In the long run, it is going to be the person who has got the legitimate lawsuit who is not going to get any money because there is not any to be had because the company goes under and people lose their jobs.

Mr. SPADONE. And, the other side of this is, too, and it is mentioned but not as often, in a small business, the percentage of time that we devote to the subject has skyrocketed with the cost and with the risk.

Mr. MCKINNEY. What would be your percentage of time, just for the record? I would be interested. I heard last night on CBS that your ladder company spends 20 percent of its time on insurance matters.

Mr. EDWARDS. I would say it is a high percentage, somewhere in the area of 15 to 20 percent.

Mr. MCKINNEY. I do not know if the chamber wants to add anything.

Mr. HITCH. Let me comment on that just by saying that I spoke with one of our small businessmen who told me that years ago, he very rarely was in touch with a lawyer, except for a will, something of that sort. Now, he is spending all of his days with a lawyer. He has to have an office in his small plant to do that.

Mr. MCKINNEY. I think I went to Congress at the right time. My lawyer became a constant companion again.

Mr. MAVROULES. I have one final question. We have been hearing a lot about the proposed bills here this morning, and some of the opposition to them. The opponents claim that the only reason the bills are being put forth and people are supporting them is to take care of the carelessness of manufacturers.

Would you care to comment on that, on the manufacturers who do not care about improving the quality of their products?

Mr. EDWARDS. I did not follow that.

Mr. MAVROULES. Well, we have bills before the House, we have Danforth and Kasten on the Senate, we have Ron Wyden in the House of Representatives, and others. The opponents to those bills claim that the bills are there just to protect shoddy manufacturers. Would you comment on that? You mentioned that before, Don.

Mr. EDWARDS. I do not understand how anyone could perceive that those bills are there to protect the shoddy manufacturers.

Mr. MAVROULES. That is what they are saying out there, Don, so let me say it to you.

Mr. EDWARDS. It just does not, it just does not make any sense at all, and I cannot foresee how anyone would have that point of view.

Just to bring this thing a little local again as Stu did regarding the Stamford railroad station, I am involved with junior achievement of southwest Connecticut. Junior achievement is headquartered here in Stamford. National junior achievement, and you know that program.

Well, last year, we were told that we could no longer let our junior achievers use power tools in the workshops because the school systems where we held the junior achievement meetings because there was no carrier in the country that would any longer ensure the use of power tools by the use of junior achievers, and we had to disband the use of power tools in junior achievement programs.

It was not the cost. It was that we could not get a carrier.

Mr. MCKINNEY. The bookcases and all the rest of that.

Mr. SPADONE. No manufacturer, no businessman can stay in business in 1986 with an attitude of excusing shoddy manufacture. If you do not believe it, look at the Japanese cars, the Japanese radios, the German products, and the size of the imports in this country. The people will not be fooled with shoddy goods.

Mr. MAVROULES. Thank you very much, gentlemen, for your excellent testimony.

Panel No. 4. Ms. Lee Imershein, Options-Roommate Service, Inc., Stamford, CT; George Bellinger, BAR PAT Manufacturing, Bridgeport Minority Purchasing Council; and Kenneth Schwartz, SATTVA Chemical Corp., Stamford; Raymond Alletto, Bridgeport Machine.

Welcome. Good morning. Is someone missing here? Kenneth Schwartz is not here.

Good morning, and thank you for appearing before us this morning. We will go right on with the testimony.

Ms. Imershein. Am I saying that correctly?

Ms. IMERSHEIN. Yes, you are.

Mr. MAVROULES. Thank you. Please start.

TESTIMONY OF LEE IMERSHEIN, OPTIONS-ROOMMATE SERVICE, INC., STAMFORD, CT

Ms. IMERSHEIN. Thank you very much, gentlemen.

I feel I must say that I think I represent a lot of women. I believe the last statistic I read of small businesses being founded by

women was something like 35 percent. Compared to figures that have been used here, my business is very, very, very small, but it started out as a sole ownership, then became a partnership when I joined it, and then we were incorporated in 1983.

We had one carrier until that time. After we were incorporated, another carrier took over, sent us a renewal certificate for the time period, I think it was, November of 1983 through November of 1986. In 1985, that company merged with another larger insurance company, and we were sent a notice that the company that had taken over had succeeded to all rights and obligations for the previous company, including our policy.

But they also notified us at that same time, that they were canceling, would not renew our policy as of November of 1985. Since that time, our agent has tried every carrier that they could think of and have been unsuccessful. They will not even give us a price, much less agree to cover us.

When I spoke to her on Friday, she had sent out five requests earlier this month and had already received three notifications; one from a company in Connecticut, one from a company in Massachusetts, that they would not cover us. She also had contacted the Market Assistance Plan and as of this time, they have not given her an answer. I think because they do not know what to do with us because of the nature of the business.

Now, my service, according to most of the real estate people in the area, and to most of the large and small corporations, is a very necessary service, particularly in that I service lower Fairfield County, where the rents are so exorbitant. But, quite frankly, I cannot continue in business if I do not have some insurance because of the danger to my family.

Mr. MAVROULES. Let me interrupt you. Please excuse me.

Ms. IMERSHEIN. Surely.

Mr. MAVROULES. What is your service? You know, it sounds funny. Roommate.

Ms. IMERSHEIN. I understand.

Mr. MAVROULES. Could you explain?

Ms. IMERSHEIN. Actually, I am involved in home sharing. I interview, check references, and make referrals to get people together to share where they live.

Mr. MCKINNEY. In this part of the country, it is very difficult for someone from the Elysian fields of Boston to understand, housing is getting very expensive.

Mr. MAVROULES. Try Boston now.

Mr. MCKINNEY. We make sure there are two and pretty soon there will be five people——

Ms. IMERSHEIN. Well, I have some where there are already five people, but so far, there are five bedrooms involved. But, you can imagine that in this business, the possibilities of a suit are unbelievable. That was why our legal counsel recommended that, even though we were incorporated, we continue to carry liability insurance.

My premiums went from $450 to $650 but that is over 2 percent of my gross income. They will not even quote me a price, regardless of getting the insurance coverage.

When this all happened, I wrote a letter to Mr. Gillies, received a very prompt response. I copied to Mr. McKinney and Mr. Weicker simply because I knew he was on the Small Business Committee, and I received an answer from him just a few days ago. Then I received a letter from Mr. McKinney asking me to attend this hearing. The young lady spoke to me on Friday and asked me if I would come and speak.

Mr. MAVROULES. You have requested insurance coverage and cannot get it. Is that what you are saying to us this morning?

Ms. IMERSHEIN. That is exactly it.

Mr. MAVROULES. Let me ask you the very same question. Did you have a good record with the insurance company prior?

Ms. IMERSHEIN. I had no claims filed. I had had no threat of filing a claim.

Mr. MCKINNEY. It is a real small business.

Mr. MAVROULES. I know.

Mr. MCKINNEY. How many people do you have working for you?

Ms. IMERSHEIN. Well, two, maximum. There are a lot of women who have very small businesses. Most of us are service oriented. I do not think that they feel that they are in as much danger as we personally feel we are in.

As you can imagine, anything can happen when you get two people together to share a room. I quite often say that the relationships that seem to develop among the people who are sharing are much like siblings in that regard, but it really is frightening when you stop to consider what could happen, and no one, no carrier that my agent has approached will even give them a quotation.

Mr. MAVROULES. Thank you very much.

Ms. IMERSHEIN. I am a one person business. Please excuse me.

Mr. MAVROULES. OK. Fine. Thank you very much.

Mr. MCKINNEY. Thank you.

Mr. MAVROULES. We appreciate your testimony.

Mr. MCKINNEY. George is from Bridgeport. We got snowed out, it seems to me, when we went together with an astronaut and God dumped on our canoe that day. George has supplied minority unemployment and employment to people who were unemployed and did a fascinating business.

Mr. MAVROULES. Good. Delighted to hear that.

George, would you proceed with your statement?

TESTIMONY OF GEORGE BELLINGER, BAR/PAT MANUFACTURING, CONNECTICUT MINORITY PURCHASING COUNCIL

Mr. BELLINGER. Yes; I was asked to be here representing the Connecticut Minority Purchasing Council, not the Bridgeport, which basically represents about 3,000 minority businesses in the State.

We have problems polling them, but the little polling I did, I found out that most of them did not have liability insurance, did not consider themselves to be in danger and did not worry about it out of ignorance. We do not know how to counsel them because they do not choose the business to go into, they have the skill or the craft to go in it, and that is all they can do, and if the insurance premiums are too high, they just do not get it.

But I would like to relate some stories of my business, which is a manufacturing business of electronics. I was quoted by a commercial airplane company to make a cable, and I gave them the quote, and the purchasing agent was friendly enough to show me the boiler plate that had passed the liability insurance on to me.

I called my carrier. The premiums were higher than the order, so I did not take the order. We are trying to penetrate the medical instrument market and have gone through a lot of problems to get FDA approval to manufacture these units, and have had to cancel an order because after I built 100 of 500 units, it was brought to my attention about the liability insurance, and, again, the premiums were more than the order. So that if she is talking about tiny, small businesses and that is what I represent, you just cannot buy the insurance. You cannot afford it.

Fortunately for my business, I have the insurance because I do not think the insurance agent understands what I do.

One other question was how much time do I spend with this. I do not spend any time. The insurance agent scares me to death and I pay him. They come in with the horror stories. We have got to remember that they are selling the insurance, OK, and they give you the horror stories and you pay them.

The third—I am on the board of directors of Bridgeport Hospital, and at the annual meeting a couple of weeks ago, the insurance premium for Bridgeport Hospital went from $800,000 last year to $1,600,000 this year, and it was kept down by the hospital agreeing to self-insure the first $3 million.

So that the last point I would like to make is that as I sat here and listened to a lot of words about tort and liability, the ending is us. "Sixty Minutes" said that people consider this a lottery ticket. Someone leaned over and whispered to me just now, why are not more people here. People use this slicing of the finger on a machine to get a down payment on their expensive house in this part of the country. It is a lottery ticket to the public, and if we do not keep that in mind, you pay the juries and the judges and all the people involved, you know, not only the lawyers, we are the enemy.

Thank you.

Mr. MCKINNEY. I get the feeling George is sort of saying sue the company and if you lose, sue the lawyer that sued the company.

Mr. MAVROULES. Probably, Stew. That was good testimony. I appreciate that very much.

Mr. MCKINNEY. Ray.

Mr. MAVROULES. Raymond, would you proceed?

Mr. MCKINNEY. Bridgeport used to be the machine capital of the Northeast, Mr. Chairman.

Mr. MAVROULES. OK.

Mr. MCKINNEY. I want you to remember that. I stood in front of Bullard Machine Tools and looked at a cornerstone that said that the building had been built over 100 years ago. It is no longer in business.

TESTIMONY OF RAYMOND J. ALLETTO, MANAGER OF LEGAL ADMINISTRATION, BRIDGEPORT MACHINES

Mr. ALLETTO. For the record, my name is Raymond J. Alletto, and I am the manager of legal administration for Bridgeport Machines.

The financial burden to small companies who manufacture machine tools demands immediate attention. The machine tool industry, as Congressman McKinney points out, has been and is an integral part of the Connecticut economy.

The influx of imports into the United States and its economy during the last 5 years is now exacerbated by the prohibitive cost emanating from a runaway tort system. The purpose of strict tort liability principles, judicially created in the 1960's, was aimed to move away from a conduct based examination of responsibility for harm and focus solely on the safety of a product for its intended usage.

This analysis was intended to shift the burden of the cost for product-related harm to the responsible party who is best suited to bear it.

I feel that it is shortsighted to blame the product liability law for the current state of affairs. In fact, many prudent manufacturers have spent considerable time and effort learning how to prevent lawsuits and thereby avoid the costs. We have undertaken an understanding of the law, instituted a good risk management program and entertained a sincere commitment to the goal of making safe and reliable product to help achieve the desired result.

For example, of 200 claims filed against the machine tool builders, which were closed in 1985, only 15 percent reached trial, and only 8 percent resulted in plaintiff verdicts.

Mr. MAVROULES. Would you repeat that, please?

Mr. ALLETTO. 200 claims which were closed in 1985 against the machine tool industry, only 15 percent of those cases reached trial, the rest were either dismissed or settled, and only 8 percent, which is only 15 cases out of 200, resulted in plaintiff verdicts.

These successes, however, are not indicative of a fair and equitable system. For example, in the machine tool industry survey recently taken, the average verdict in 1985 was an alarming $297,500, an increase of 22 percent over 1984. Settlements averaged $91,000, a 100-percent increase over the previous year. The cost of defending these lawsuits has reached profound new limits. For every $7 paid to an injured plaintiff, $6 is paid in legal fees and court costs. We can all tell stories of the sympathy-evoking plaintiffs and lawsuits that lack basic causation foundations. Frivolous suits are now commonplace. One California court has even held that the plaintiff need not prove that the defendant manufactured the product. Market share liability has now been creatively conceived. A New Jersey court has found that we should have labeled warnings against foreseeable dangers of our products at the time of manufacture, dangers which were unknown to the industry at the time of manufacture. Thirty percent of the current cases in the machine tool industry relate to products manufactured prior to 1950. A large proportion of our lawsuits are filed by insurance companies who are workers compensation insurors and subrogate to the rights

of the employers that they insure to recover their outlays. This can occur with a total ignorance of the employer's comparative liability for the work place accident. Manufacturers are forced to pay exemplary or punitive damages, the sky is the limit, for manufacturing a defective product and pay those damages more than once for the same product defect.

To sum, we have seen inexplicable vitiation of basic tort liability principles applied by State courts in 50 different sets of rules. American business has remained solvent throughout this whole ordeal by protecting itself with commercial insurance, but as we know, 1986 has brought with it a new crisis.

Despite the successes to which I alluded earlier with respect to loss prevention, 1986 premiums in our industry increased an average of 157 percent over 1985. Rates have increased with a total and conscious disregard of experience ratings, loss histories, and claims prevention efforts of the insureds.

Ten percent of the machine tool industry in the United States has no insurance at all. Twenty percent of the machine tool builders have no excess or umbrella insurance above the million dollar primary insurance mark.

At Bridgeport Machines alone, I can say that our insurance has gone from $600,000 in 1985, to $1.2 million, and we had $4,300 worth of losses last year.

Mr. MAVROULES. How much?

Mr. ALLETTO. $4,300 in losses.

Mr. MCKINNEY. Wait a minute now. You are paying $100,000 a month then for insurance premiums?

Mr. ALLETTO. Yes, sir; and, we had losses last year, Mr. McKinney, of $4,300.

Mr. MCKINNEY. What are your sales?

Mr. ALLETTO. Sales of approximately $200 million.

Mr. MCKINNEY. When I first owned my house, this is a side comment that I will just throw out because there are some old people like Joe Schachter and myself in the room, if anyone had ever told me that my oil bill was going to be bigger than my mortgage, I would have shot them on the spot. Now, I am beginning to find out my insurance bills are bigger than the oil bills.

Mr. MAVROULES. No question about it.

Mr. ALLETTO. The insurance industry blames the tort liability system which, as I described, is in obvious disarray. Insurors, in my opinion, will not consider rate decreases until tort reform is a reality.

The consumer activists, on the other hand, are equally correct in censuring insurance carriers who underwrote for at least 5 consecutive years at low prices to compete for the greater volume of premium dollars in the market. When their investment returns experienced significant shortfalls and with their reserves under regulations by the State, they were caught with net losses. Certainly, if the reserves were not so necessarily high, due to the unpredictable tort system, profits might have been realized. I believe that placing blame at this point appears to be fruitless.

One solution which has been discussed this morning is the Danforth proposal, Senate bill 1999. It appears, in my opinion, to address the salient points of controversy. It provides that there would

be no right of subrogation in a product lawsuit, and as I indicated, that would eliminate a substantial amount of the lawsuits against product manufacturers.

It institutes a 25-year statute of repose, which is a very long time and we are not specifically pleased with it, but we will take it. That would eliminate 30 percent of the lawsuits for products manufactured prior to 1950.

See, in some States, there are statutes of repose, and in some States, there are none. This would be 25 years. In Connecticut, we have a 10-year statute, but many States have no statutes at all.

It would institute a limit on punitive damages, not insofar as a cap, but with respect to the proof—you know, bifurcate the issue of punitive damages at trial. There would be more of an intent than a negligent standard, and the evidence would be clear and convincing as opposed to just a preponderance of the evidence to prove and obtain punitive damages.

Finally and most importantly with the Danforth proposal, there is an alternative no fault claim system where the claimant could recover net economic loss only, which would be his lost wages and medical injuries from the product manufacturer without resorting to litigation. The defense and transaction costs could be significantly reduced with this kind of a system. The courts, of course, remain an option if a claim is rejected by the product manufacturer.

Also, under this system, insurors could actuarially determine an accurate loss projection from known factors of recovery. This bill is not a panacea for the defense. There are problems with record retention provisions and there are problems with the shifting of the burden of proof to the defendant should the litigation ultimately ensue.

During the last 6 or 8 years of product liability reform efforts, headed by Senator Kasten, who is, by the way, a cosponsor of this bill, those efforts will continue to be rejected unless an alternative claim system approach is integrated into the plan.

I believe the Danforth proposal provides a balance of those competing interests. I urge you to study it and give your support serious consideration.

Thank you.

Mr. MAVROULES. Thank you very much, Mr. Alletto.

Welcome, Mr. Schwartz. We are prepared for your testimony at this point.

TESTIMONY OF KENNETH SCHWARTZ, SATTVA CHEMICAL CORP., STAMFORD, CT

Mr. SCHWARTZ. Thank you.

First of all, I am sorry for being late. I had some secretarial problems this morning.

I will read my statement. Our company, SATTVA Chemical Co., Division of AC Industries, Inc., is a merchant of chemicals established in 1974.

Our annual sales volume is approximately $4.5 million, and we have offices in Stamford, CT, and St. Louis, MO. Our business is in the distribution of chemicals to U.S. industries, about 8 percent of which we import, with the balance being made nationally.

Major countries from which we import are Japan, Argentina, Austria, France, United Kingdom, Germany, and Finland. We sell approximately 50 different chemicals to about 100 customers in 30 to 40 different industries. In some cases, we ship directly from the pier upon arrival or from the domestic manufacturing sites. In other cases, we store material in our network of leased warehouse space nationwide.

Mr. MCKINNEY. A little louder. I think we need to recap that.

Mr. SCHWARTZ. OK. Additionally, we have about 10 percent of our product repacked and 5 percent processed on a contract basis.

In our 12-year history, we have never had a product liability claim, let alone a product liability loss. Since 1982, we had a product liability policy through the Ideal Mutual Insurance Co., which cover $1 million of losses with no deductible and no exclusions with a premium of $1,800. In late 1984, this policy was canceled due to the bankruptcy of the underwriter.

It should be noted that many of our friends, whose carriers did not go bankrupt, had their policies either canceled or not renewed at the same period of time.

At that time, we conducted an exhaustive search for a new product liability insurance, as it was our decision that such was necessary for us to continue in business. Most underwriters contacted refused to quote. The only one that did was Admiral Insurance Co., which quoted $40,000, for a $500,000 policy with a deductible of $2,500, which excluded pollution claims and carried a 4-percent tax of $1,600.

Effectively, our rate increased 46 times, not even taking into account the deductible or the exclusions.

For 1986, after another exhaustive search, we located an offshore insurance cooperative who agreed to insure us under a very complicated arrangement, under which we are compelled to buy stock in the company, pay rates of approximately 70 percent of the above Admiral policy, and then receive substantial refunds of those rates as profit sharing if the loss record of the insurance company allows them.

In addition to the costs above, this problem has required countless hours of management time and the endless questions posed by various potential underwriters that required similarly countless hours to clarify. Clearly, there is also a hidden tax on productivity that this crisis has exacted.

I am not entirely unsympathetic to the plight of the potential insurance underwriters for a company such as ours for the following reasons:

First, our product line changes frequently and unpredictably.

Second, the industries which we sell to conceivably have large losses, if our materials are defective, due to their large-scale production and/or the sensitive nature of their use. For example, we sell materials to nuclear powerplants, ophthalmic solution manufacturers, food companies, Department of Defense subcontractors, manufacturers of industrial catalysts, processors of precious metals, manufacturers of polyurethane foam, among many others.

Third, as our materials are inevitably handled by personnel beyond our control, both here and overseas, damage could easily

occur to the goods which could expose other people and/or the environment.

To address these valid concerns, we have instituted a variety of policies and procedures which we feel amply address these points, and which none of the potential underwriters have found to be unsatisfactory.

As a solution to our problem, we have done a few things that have been in our control: First, joining the insurance cooperative as noted above; second, writing letters to our legislative representatives. In fact, Congressman McKinney is responsible for my appearance here today. Third, we have asked our customers to help defray our product liability insurance by charging them an additional fee for invoice, an explanation of which is attached to our statement. I will make it available to you.

It seems unlikely that there is massive conspiracy between underwriters, potential underwriters with the collusion toward direction of reinsurors. Therefore, this slightly educated layman is forced to believe the assertion of the insurance industry that the sometimes excessive and often unpredictable awarding of claims is a driving force behind the crisis.

The statements of consumer groups that rates had increased to compensate for the lower return on the insurance company's investment portfolio due to lower interest rates does not seem to address the two key points. First, that rates and declinations have outpaced the drop in insurance rates beyond any imaginable multipler effect. Second that the insurance companies are seeking excessive profits derived from their combination of investment and premium income.

The free market system should motivate lower priced competition to seek more of its share. Therefore, it seems to me that it is the responsibility of our elected Representatives to ascertain whether such collusion exists. Assuming it does not, we must take positive, meaningful steps to normalize and standardize tort law to give insurors and reinsurors an incentive to re-enter the market at reasonable levels.

The doctors who delivered my 6- and 8-year-old daughters have recently discontinued the practice of obstetrics. The stables at which I used to ride are shut down. My company's profitability and productivity have been sorely taxed and the situation becomes increasingly serious with each passing day. Without a change in the system, one can only foresee a continued erosion in the availability of goods and services and a steady escalation of the prices of those which remain available to offset the increased costs, such as those referenced above.

Thank you very much for your consideration.

Mr. MCKINNEY. Well, Mr. Chairman, you missed a description of one of the most confused ways to cure yourself that I have ever heard of, but at least Ken has insurance for awhile.

Mr. SCHWARTZ. Right.

Mr. MCKINNEY. Albeit at cost.

You had some very good testimony on percentage of lawsuits that have gotten to juries and been settled, et cetera. Have you been sued, to start with?

Mr. SCHWARTZ. No. We never had a claim.

Mr. McKINNEY. Never had a claim.

Mr. SCHWARTZ. No single claim.

Mr. McKINNEY. George.

Mr. BELLINGER. Never had a claim.

Mr. MAVROULES. I just want to ask one question, though.

How do you feel about the bills that are going through the Senate at the present time? The Danforth and the Kasten bills.

Mr. SCHWARTZ. I must confess I have not read them yet.

Mr. MAVROULES. I think Raymond referred to it. You probably walked in late on that.

Mr. SCHWARTZ. Well, you know, as I heard him reading on this, I would like to learn a little more about it.

Mr. McKINNEY. Or it could be the comment that a small businessman made to me, "I am running my damn business, you can take care of that nonsense in Washington to make sure I can run it." That is almost a point we are at. I am amazed.

I cannot possibly conceive of taking the time you must have taken to figure out this method of insuring yourself. You know, in my old tire business, you called up the agent, you said insure it, and you walked. You did not want to know about it because you were too busy trying to survive. Between government regulations, which in the tire business are ferocious, and the time needed for insurance problems, I would not have any time to spend on my business.

Mr. SCHWARTZ. It has taken a lot of time.

Mr. McKINNEY. How many employees do you have?

Mr. SCHWARTZ. Nine.

Mr. McKINNEY. Nine.

Mr. BELLINGER. Just to give you some numbers, he said Bridgeport Machines had revenues of $200 million. The hospital has revenues of $90 million and pay $1.6. million.

Mr. McKINNEY. I am an emeritus member of that illustrious board and the problem is becoming grinding, a grinding problem.

Mr. ALLETTO. I might point out that you may or may not be aware of it, that Bridgeport Machines is currently going through a management buyout, and we will soon be probably qualified as a small business, and in our efforts getting ready to buy the company from our corporate parent, we had to put together an insurance program on our own without the help of our parent corporation.

Sixteen companies were approached, and we received 15 declinations to even quote, and here is a company—the history of the company since 1938, we have had one plaintiff verdict against us.

Mr. McKINNEY. You are a part of Textron?

Mr. ALLETTO. Right now, we are a part of Textron.

Mr. McKINNEY. And, Textron——

Mr. ALLETTO. Is selling the company. Fifteen companies were approached and we finally got one company that would even agree to quote and that was the $1.2 million.

Mr. MAVROULES. That is the difficult part, too. I cannot comprehend that at this point, but we will down the line, I can assure you.

I do not have any other questions. Stew.

Mr. McKINNEY. I mean, it used to be that if you paid enough, you got insurance. Now, you are being told that you cannot get it even if you pay too much.

Mr. SCHWARTZ. Or if you get it, you get your supper.

Mr. ALLETTO. They are not willing to accept the risk. I mean, you know, for them, the machine tool industry, the builders of machine tools and people operating machine tools get hurt oftentimes in the workplace. They do not want to touch it.

Mr. MCKINNEY. You know what amazes me, and I think it is changing. What we see in Time magazine, U.S. News and World Reports, 20/20, these hearings and hearings in Washington is that people have assumed that money from insurance claims is going to come from somewhere, the deep pocket. Money is coming from the poor people walking up and down the sidewalk there, whether it is paying more for the product, more for the insurance, more for this, more for that. The money is not, you know, magically appearing out of the sky like rain.

I think that is one of the things that the chairman and I are so concerned with.

Mr. BELLINGER. It is nice to hear a Congressman say that.

Mr. MAVROULES. Well, it is true.

Mr. MCKINNEY. George, how many people do you have now?

Mr. BELLINGER. Thirty-five.

Mr. MCKINNEY. Thirty-five. All minority?

Mr. BELLINGER. No.

Mr. MCKINNEY. No. But mostly minority, a lot of minorities?

Mr. BELLINGER. Yes. Mostly.

Mr. MCKINNEY. Innovative, different, and many are hard roads to hoe with BAR/PAT.

Mr. MAVROULES. Have I told you, Stew, my brother-in-law runs a small dairy business back in Massachusetts, retail, not wholesale, mostly retail, and his insurance rates have gone up by 70 percent. They are now paying $1.2 million, and they do not even gross that much. They are hurting. So, it is a national problem. There is no question about that.

That is why we are here, to see if we can get some information and maybe move it along a little bit.

Gentlemen, thank you very much for great testimony.

Mr. MCKINNEY. Thank you very much.

Mr. MAVROULES. And, our final panel, Mike Noonan, director, Committee on Political Education, AFL–CIO; Ms. Mary Gay, Southwestern Victims Association; Mr. Richard Bieder, Koskoff, Koskoff and Bieder, Connecticut Trial Lawyers Association; and Joseph F. Bennetta, International Brotherhood of Teamsters.

We welcome you and we will go right into the testimony.

We have about 40 minutes. Let us see if we can get through in that time. OK?

Michael, would you proceed, please?

TESTIMONY OF MICHAEL NOONAN, DIRECTOR, COMMITTEE ON POLITICAL EDUCATION, AFL–CIO

Mr. NOONAN. Thank you.

For the record, my name is Michael Noonan, and I am the director of the Committee on Political Education for the Connecticut AFL–CIO.

Good morning. Connecticut faces a crisis which is moving across this country. That crisis is in the cost and availability of insurance. Many diverse groups and individuals are affected by this current situation.

Businesses, both large and small, day care centers, health service providers, nonprofit agency board members, municipalities and professionals are all finding the availability of liability protection extremely difficult to either obtain or maintain at any cost.

Example after example of twofold, threefold, and fourfold increases in premiums or sudden notice of nonrenewal or cancellation are too often the norm these days. If you ask the insurance companies why, they blame the current tort system, greedy victims and their lawyers, and a large amount of overexposure and unpredictability in the policies now in effect.

They likewise express a general poor investment economy as a major contributing factor. To be honest, my organization and its membership do not share these feelings. Too many insurance companies in general are out to gouge higher profits at the expense, the ultimate expense, of the consumers who pay the price for increased insurance premiums.

The issues must be examined if the truth is to be found. Contrary to what the industry states, insurance companies are extremely profitable operations. They are extremely complex operations which, by and large, operate outside the public eye and government monitoring. They do not come under the Federal antitrust laws and are exempt from Federal Trade Commission examinations. They pay no Federal taxes and are allowed to operate within most States with little, if any, monitoring or reporting requirements.

They claim that they are losing massive sums of money, but, according to a GAO profit study, between 1975 and 1984, property casualty companies made $75 billion in profit. The industry claims the number of tort actions and the size of awards are both going through the roof, but the Institute for Civil Justice reports the number of tort actions in the courts has increased as the percentage of the population by no more than the gross of our population since 1960. That same group also reports that awards have increased by no more than the increase in the inflation during the same period.

The industry claims that its exposure on existing insurance policies is too great, but they are the ones who made the decision to issue these policies based on poor underwriting practices common in the late 1970's across the industry.

During that period, with interest rates and investment returns so high, the insurance industry was really only interested in collecting the premiums to reinvest them for even greater profits. What the industry would like is a shifting of the rights of victims of negligent actions from gaining complete recovery for their losses, but, in return, they offer little, if any, guarantees that the current situation of high costs and the problem of availability will be corrected.

In States where tort reform has been enacted, most problems still exist. Policies are still being canceled, and the cost of coverage is still on the increase. Iowa passed changes in its laws dealing

with tort actions, and 2 years later, many counties in the State still could not afford liability coverage.

What is often the situation with businesses today is that as premiums increase, the amount of insurance coverage decreases. Some businesses as well as municipalities and professionals are even choosing to go without insurance protection entirely. In cases such as this, one accident could result in losses so severe that the firm could be forced to close and municipalities forced to cut services and dramatically increase taxes.

Mr. McKINNEY. Michael, excuse me for interrupting you. The victims, quote unquote, will then get no coverage at all if that firm is bare?

Mr. NOONAN. Yes.

Mr. McKINNEY. And, the victim will be without any help at all, any reasonable help.

Mr. NOONAN. Exactly.

One basic problem with truly understanding the financial situation of insurance companies is their accounting practices. The commonly used methods are often more conservative in projecting their positions than under generally accepted accounting principles.

Frequently, premiums collected in operating expenses and losses do not tell the total story of the company's position. Without a requirement to show dividends to policyholders, unrealized capital gains as well as growth or losses in surpluses and reserves, it will be difficult to make a complete analysis.

Our examination of Connecticut insurance laws shows that competitive market approach to establishing rates does not serve the best interests of any one except insurance companies and their profits.

As Connecticut laws are weakened and their methods of reviewing premium increases filed by companies with the insurance commission, companies should justify the reasons for such rate requests prior to those rates going into effect. What we believe is needed are several changes in both State and Federal law.

First, insurance companies must be required either by State or Federal Government to disclose full financial information on their operations, including income, regardless of type, losses and reserves.

Second, they should be required to justify premium increases above a certain percentage.

Third, insurance companies should not be exempted from Federal antitrust laws and should be required, when necessary, to submit to Federal Trade Commission examination.

Fourth, based on Connecticut's dismal showing, the Federal Government should urge States to conduct some more extensive review of premium schedules filed by companies and increase the stats of State insurance departments for general oversight purposes.

Insurance companies operate in cycles within changing economic and financial conditions to better serve the many businesses, individuals, and groups which need the protection of the good coverage. We should look to better reporting and review of the industry, not to undermining any legal rights of individuals to recover when victimized by a negligent action.

With better disclosure by companies and the ability by Government to examine their practices when necessary, all consumers of insurance will be better served.

Mr. MAVROULES. Thank you very much, Mr. Noonan.

Ms. Gay, would you proceed?

TESTIMONY OF MARY GAY, SOUTHWESTERN VICTIMS ASSOCIATION

Ms. GAY. Thank you. My name is Mary Gay. I am president of the Fairfield County Victims Association and mother of a malpractice victim.

I would like to address the so-called insurance crisis by describing a likely scenario.

Picture an auditorium in a remote area filled with executives from every insurance company in the Nation. A panel of the most powerful is on stage. The chairman:

> Ladies and gentlemen, interest rates are coming down, so it is time for another major plan. We are calling it operation blindfold.
>
> First, we increase the premiums as high as 1,000 percent, policies that will impact directly on middle- and low-income people. The first effect will be skyrocketing medical costs. Those on fixed incomes will be hardpressed to find adequate medical care. High practice premiums will also eventually force some doctors to give up practice and new doctors to leave the country to practice.
>
> The AMA will soon be in bed with us. Day care providers will pass on their rising costs onto the working women and we all know how vocal they can be. Then, we will squeeze the municipalities dry, public service will be affected, schools, sports, and special programs will have to be canceled. The taxpayers and the kids will be in an uproar.
>
> Understand, people will even be forced to refuse to insure, in some cases, and make it look really good. Believe me, the plan is foolproof. The key is in making the working people angry. We will convince the public that they have a greater out-of-pocket expense as a result of an increase in jury awards. The media will eat it up. They already give great press to the most sensational cases and, ladies and gentlemen, the victims are so few in number they cannot possibly raise the money or the strength to fight this, and we have so much power, we can buy whomever we want.
>
> Let me emphasize, we cannot focus attention on the actual victims. We must make the public feel like victims. We must make them believe the insurance industry is a victim of a litigious society. Believe me, operation blindfold will take off like a shot once we set the wheels in motion.

The best part is no one will ever be able to prove the conspiracy.

The insurance industry says they are in trouble. If we take off our blindfolds, we can see there has been no devaluation of the insurance stocks. We will see insurance executives taking no pay cuts or refusing no bonuses. We will see that none of the industry's vast holdings in real estate have gone to auction. We have only to use logic to know something is very wrong.

My son's brain was badly damaged by a mishandled labor and delivery. His capacity has been significantly diminished, and my family's lives will never be the same. We have been robbed of our normal son. Our hopes of his future are smashed each time we see a neurologist. The insurance company would have victims like my son become victims again. Victims of their greed, victims of legislation that would prevent trials with juries that can make awards after hearing all of the evidence.

Take off your blindfolds, people, and see this ingenious conspiracy on the part of the insurance industry to oppress the weakest minority, the victim. Thank you.

Mr. MAVROULES. Thank you, Ms. Gay.
Mr. Bieder.

TESTIMONY OF RICHARD BIEDER, KOSKOFF, KOSKOFF & BIEDER, CONNECTICUT TRIAL LAWYERS ASSOCIATION

Mr. BIEDER. Thank you, Mr. Chairman, Mr. McKinney.

George Orwell was only 2 years off. The year of disinformation was not 1984, but 1986. I do not happen to have $30 million to spend on advertising to convince the public that black is white. I do not have millions and millions to spend on advertising to corrupt and destroy the jury system.

I do not have millions and millions to spend on advertising and millions and millions more to spend on lobbying to distort the true facts.

I was present in the Connecticut legislature when the insurance industry pushed for no fault automobile insurance, claiming it would decrease rates by 15 percent. I was there. I heard them, and I am not lying to you.

The legislation passed, and immediately rates went up. The insurance companies used to have to get prior approval of their rates, before they imposed them in the State of Connecticut. I was in the legislature when they pushed to have that consumer protection removed, guaranteeing that in doing so, it would send rates down. I was there. I heard them promise, and I am not lying. The result, the legislature eliminated prior approval, and immediately the rates went up.

Mr. MCKINNEY. What year was that?

Mr. BIEDER. 1973. In product liability, they are telling you now they need something more definite. They cannot be—we cannot have all of these different rules. I was in the legislature in Connecticut in 1979 when they said we need more definiteness. Give us, you legislators, more definiteness, pass this bill that we are supporting and we guarantee you that product liability rates will go down.

The law exactly as they wanted it passed, and immediately prices went up. I was there in 1976 and 1977 when the insurance industry took out a multimillion dollar advertising campaign to end what they called then the products liability crisis, not dissimilar, although much less costly than the campaign we have seen so far and from what I understand we are going to see between now and the end of April, with the opening attack coming in the New York Times magazine section yesterday.

You, Mr. Chairman, and you, Mr. McKinney, and the public just cannot believe anything the insurance industry says. They have a social conscience of a barracuda. Am I mad? You bet your life I am mad.

Why do I say that about their social conscience? Why do I say you cannot believe any story that they tell you? Because in the past, their horror stories turned out to not be true. They used to say in the campaign in 1976 and 1977 that there was then 1 million products liability cases a year.

A lawsuit was brought in Connecticut under Connecticut's unfair trade practices act, challenging that act and challenging that

among other allegations. When put to the test, under oath, they were forced to admit that there was nothing to substantiate that there were 1 million product liability cases a year. It was only 50,000 a year, up from 47,000 a year.

They said in the advertising campaign, and you probably heard it, they told you the story about this guy who took his lawnmower, lifted it and cut his hedges and cut his finger off and he sued and he recovered. That would be horrible. I was defending that story for 15 years at cocktail parties. How could you possibly do a thing like that?

In that lawsuit, we asked them to substantiate the case and no such case existed. They said then that the average product liability verdict was $350,000. That is what they said in the advertising and that is what they were saying in 1976 and 1977. When we asked them to justify it, the only closed claim study that had been done demonstrated that the average product liability verdict was somewhere in the neighborhood of $26,000, not $350,000.

Now, it is the same. They say the average award now in cases, in products liability cases, is $1 million. That is what they are saying. When asked how they arrived at that figure of an average of $1 million, they said that they relied on Jury Verdict Service out of Chicago.

When the Jury Verdict Service in Chicago was asked what did they base it on, they said we only based it on the amounts that juries awarded and one of the cases we based it on was the $145 million verdict against Pinto out in California. Well, you might think that that one verdict might tend to skew a little bit, the figures that they are talking about. What they do not take into consideration and the Jury Verdict Service did not is all of the suits that are lost, the fact that the $145 million verdict was remitted down to $3 million in California, so the plaintiff got nowhere near $145 million.

It is analogous to us saying if you in the Congress said I will tell you what we are going to do, we want to find out what the average weight of all mammals is. All right. And, to get it, we are only going to weigh elephants. Are you going to listen to that garbage? I heard Mr. McKinney, and I am sorry that you said it, I am sure it does not indicate that you believed everything you heard on CBS, but I heard you say you heard somebody on CBS say that 30 percent of the medical dollar goes for preventive medicine. I would like to know, number one, who said it, and what did they mean.

There is an AMA ethical obligation not to perform a service that is not warranted, and their definition of preventive medicine may to me mean it is going to save my life. I do not call that preventive medicine. I call that maybe doing the job you are supposed to do, and I would like to see somebody justify what that 30 percent is.

Just here today, everybody has bought hook, line, and sinker the insurance companies' argument.

Mr. MAVROULES. Well, that is not necessarily so.

Mr. MCKINNEY. If we had bought the insurance companies' arguments about what a tough time they are having we would not be listening to testimony. I have been on the Banking Committee of the Congress of the United States for 16 years, fighting banks going into the insurance business. It is not because I like insurance com-

panies, but because banks seem to think they will get rich in the insurance business and I am wary. As a result I know things cannot be as bad as I am told or I would not have CitiBank and Chase Manhattan knocking on my doors.

Mr. BIEDER. Well, I am glad to hear that.

Mr. MAVROULES. We have got to take testimony. We have got to weigh all the arguments very carefully.

Mr. BIEDER. I am not judging you. I am saying everybody in general is buying the argument.

Mr. MCKINNEY. CBS did say what I said on 20/20 last night, and I just wonder. I throw it out. There it is. Thirty percent of medical costs go toward insurance costs. Based on what Mary has been through and my own experiences, I question the legal aspects of insurance. I had a lot of treatment that somebody wanted to give to me all over again. I said; wait a minute, I just went through that. The reason for more tests was the doctor watching out for his butt. I know your arguments, but there you are.

Mr. BIEDER. Well, in any event, today, even today, I heard people talk about these new concepts that they are worried about, strict tort liability, 402A.

I know from my teachings in law school that that doctrine is at least 25 years old. So, these poor puppets of the insurance industry, and a puppet is a malevolent, they are just parroting what they hear. These poor people are parroting what the insurance companies tell them, that there are new concepts that we cannot control.

402A has been around at least for 25 years. I served in the U.S. Army, and I served in the U.S. Navy, to preserve the rights that I believed then and I believe now are worth fighting for. Mainly, they are the rights of normal individuals over the rights of monolithic, arrogant, conglomerate corporations.

You know, insurance companies are not independent. They are owned by AMEX, ITT, Xerox, and the other thing that I want to protect is the guarantee that an unprejudiced jury can hear facts and decide who is right. Make no mistake about it, the goal here by the insurance industry is not only to raise already obscenely high profits, but to preside over the systematic destruction of the rights of common people to have their cases heard by a jury.

The unfortunate pawns in this diabolical plan are men, women, and organizations, like some of whom you have had before you today. Cities, companies, individuals for whom, as Mr. McKinney indicated, a basic commodity, insurance, has been priced out of sight.

Why has it been so priced? Primarily to rouse them to storm the halls and bastions of the State and Federal legislations, to have citizens' rights decimated. What has become of our native American inquisitiveness? Why have America's leaders stopped questioning the spoon-fed fodder handed to them by the insurance industry?

What is Mr. Rathgeber's position today? Why do not other people in the public ask him how much of CBIA's income comes from its insurance company members? In a boot strap compliment, Mr. Chittenden, whose member organizations are members of the CBIA, says he was impressed by Mr. Rathgeber saying that CBIA will not self-insure its members, as if they had some problems.

Maybe it is because CBIA will lose half of its funding from its insurance company members if it dares to go into the insurance business. Why are not these questions being asked by the public? Is it because the economic hostages, like cities and manufacturers, are just that, economic hostages? Is it because they do not care about the people who are victimized?

When the insurance information institute, loosely called the Insurance Information Institute, funded by the insurance industry, said, "A medical survey shows that one out of every nine obstetricians has stopped delivering babies," why do we not ask: First, does that include retiring doctors; second, does that include doctors who have been successfully sued more than five times and should stop delivering; third, where was the survey done; fourth, by whom was such a survey done; fifth, was the sample wide enough to draw frightening conclusions.

When the III says in some rural areas, women have had to travel elsewhere to give birth, why are we alarmed? From time immemorial, women in some rural areas have had to travel elsewhere to give birth. Why are we as a people scrambling to take away rights of people injured through carelessness?

Is it because the insurance industry tells us that if we eliminate the contingency fee, if we eliminate—if we put caps on pain and suffering, if we put restrictions on punitive damages, if we restrict the role of the juries, if we put penalties on frivolous suits, then insurance will be available and affordable?

In Ontario, Canada, for example, they have caps of $185,000 on pain and suffering. Almost no punitive damages. No contingency fees are allowed. Almost no civil rights to a jury trial, and the penalty for losing is that you pay not only your attorneys fees but the opponent's attorney's fees, and with all that, guess what? The insurance industry has refused to provide insurance at any price for Ontario day care centers.

The insurance industry has refused to provide insurance at any price to all but one of the 121 Connecticut school boards. The insurance industry has refused to provide liability insurance for Toronto. The insurance industry has refused to provide liability insurance at any price to the Canadian National Ski Team.

The insurance industry has raised premiums 1,000 percent. Hospitals in Toronto can get insurance but only at "greatly increased premiums." An insurance company renewed the Ontario School Bus Operators Association policy at a 400-percent increase.

That is given everything that they want legislators can take away from American citizens now. It has all been taken away from Canadian citizens, and still there is a crisis there.

Mr. MAVROULES. Mr. Bieder, we are beginning to run a little bit short on time. I would be very happy to take your entire statement and make it a part of the record if you would like.

Mr. BIEDER. I am drawing to a close. Thank you very much.

Mr. MCKINNEY. He should have been my lawyer in Maine when I was a boy.

Mr. MAVROULES. Yes.

Mr. MCKINNEY. I lost that case.

Mr. BIEDER. Fortunately, some are not blinded by blindly following the path.

Just recently, the town of Trumbull in Connecticut brought a lawsuit against its insurance carrier. Trumbull's lawsuit—Trumbull's insurance premiums have gone up an average of 350 percent with one of their policies going up 700 percent, despite the fact that—everything that you heard, decreased coverage, fewer cars insured, all kinds of exemptions, Trumbull brought a lawsuit that I have been urging all doctors and manufacturers to do for years, against their insurance carrier, claiming that the insurance carrier is committing an unfair trade practice by unfairly charging premiums that it cannot justify.

I was happy to hear Commissioner Gillies indicate today that he just does not have the facts and figures to allow him to say whether the insurance companies' rates are valid or not valid. I am sorry that he did not have those earlier.

I do not know if either of you gentlemen or anybody else up here saw the movie, "Network," but in the movie, "Network," there was a character called Harold, and Harold, at one time, decided that he was mad as hell, these were his words, he says, "I am mad as hell. I've had enough, and I'm going to do something about it."

And, he opened up his window to this apartment in New York, and he screamed out, "I'm mad as hell, and I've had enough.", and before long, everybody in New York opened up their windows, screamed out loud, "I'm mad as hell. I've had enough.", and something was done about it.

That something ought not to be taking away the foundation rights of America. That something ought to be finally and for once asking probing questions of Goliath, the insurance industry. They have never answered them.

Is there a Federal role? I know that the Chair has an interest in that question, and Mr. McKinney, I happen to be, although I am a lifelong Democrat, I sometimes think I am a Republican at heart, some of us have that—some of us in this room have that decision as to whether they are really Republican or whether they are really Democrat.

Mr. MAVROULES. Join the party, my friend.

Mr. BIEDER. I know that. But I will say that, generally speaking, I am against Government regulation, and I think the move is afoot that there should not be quite as much regulation.

There are obvious exceptions, but Representative Rodino is presently holding hearings on something that I have never ever understood. I just have a little bit of a history from hearing Ralph Nader speak the other day, but I never understood how it got in, and that was the McCarran-Ferguson exception to the antitrust laws.

Why the insurance industry is exempt from the antitrust laws, I have never understood. The only industry that has that exemption, and Mr. Nader told me the other day that in 1943, during our horrible alarming situation that we went through, the Second World War, the insurance industry had passed that exemption and it had a sunset provision to it, as originally passed. It was supposed to last the period of the war, and the sunset was for 2 years. That exemption was going to end in 1945, and somehow, when it got to President Roosevelt and I like to think that everybody signing the bill knows everything that is in the bill at the time they sign it, but I am not certain that President Roosevelt did.

Mr. MAVROULES. I might tell you that we certainly do not know everything in the bill every time.

Mr. BIEDER. Well, I have in the legislature, so I know exactly what happens.

But, that sunset provision was taken out, and, so, since 1943, the insurance industry alone has enjoyed exemptions from the Federal antitrust laws and Representative Rodino is holding hearings now to determine if that should be withdrawn.

That, I think, is a positive role, not further regulating any industry, not further regulating the people, taking away rights from anybody or giving rights to anybody, but I think it is wise for the Federal Government to intervene.

Thank you very much, and I appreciate your——

Mr. MCKINNEY. I am sorry. I must apologize for the fact we are rushed, but we have a plane to get the chairman on.

Mr. BIEDER. Thank you very much.

Mr. MAVROULES. Mr. Bennetta.

Then, I want to ask you one hard question, Mr. Bieder——

Mr. BIEDER. Sure.

Mr. MAVROULES. [continuing]. Because this is something we get every day. You have to be up front with me, and I am sure you are going to be.

Mr. BIEDER. I will.

Mr. MAVROULES. Mr. Bennetta.

Joseph F. Bennetta.

TESTIMONY OF JOSEPH F. BENNETTA, ORGANIZER, INTERNATIONAL BROTHERHOOD OF TEAMSTERS, CHAUFFEURS, WAREHOUSEMEN & HELPERS OF AMERICA, LOCAL UNION NUMBER 191, BRIDGEPORT, CT

Mr. BENNETTA. Yes; I appreciate your letting me slip in here this morning. I was not aware of this until I heard it on the radio this morning, and I spoke with my executive officer, Local 191, Tony Rossetti, and he asked me to come on down this morning.

Congressman McKinney knows that Mr. Rossetti sent himself and all the rest of the Congressmen and Senators in the State a letter as late as February 26, and being that there was an opportunity, the Teamsters wanted to go on record on response to some of the letters we sent out pertaining to insurance rates.

I just want to speak real briefly because I know you are running late. This is a small construction company, and before I get into this, we are not talking about just auto insurance. Auto insurance is a good part of the trucking industry, but some of these places, I will give you a brief description of exactly what they do, and it is not only their auto insurance, which you might think, but, basically, our product is service, these people are service companies.

Some of your larger companies, such as United Parcel Service, Roadway Express, they are self-insured now. They cannot afford to be insured any longer. But this is just a small construction company in New Canaan, a small construction company, Malazzi, only employs half a dozen people.

Last year, it was a 125-percent increase over last year. Mohegan Valley Corp., they make forms for your steps for houses, in re-

sponse to a letter, December 15, 1985, over the last 2 years, the policy years, their insurance has increased approximately 400 percent.

West End Moving and Storage, their umbrella coverage has gone up 455 percent over the last year.

Mr. McKINNEY. Joe, you know, it would be interesting for the record, and I know the chairman would be interested, too, to get any of these responses that you have got. The fact that people cannot get insurance bothers us as much as the fact that we are paying for those outrageous rates.

Mr. BENNETTA. I have one or two more here. Country Home Bakeries, 44 percent. Monroe Concrete, 50 percent. Art Lou Trucking, 50 percent. There are one or two that you might find interesting in here, and Chestnut Hill Bus Corp., taking the school kids back and forth, they have a staff at Bridgeport. Their increase was 300 percent in 1 year or $400,000, and there was one, DeFonce Construction, that did the Mianus Bridge right here. DeFonce Construction had to get an additional $5 million in umbrella insurance to be able to work on the Mianus project when that bridge went down.

In 1982, the cost of that additional insurance was $2,250. In 1983, it went up to $2,850; 1984, it went up to $3,650. In 1985, it went up to $164,715, or 44½ times or a 4,400-percent increase.

In addition, the liability went up 110 percent, and in conclusion, in this letter they sent back to us, they say, in conclusion, the job will be shut down for January, February, and March 1986, partly due to the high insurance premiums. It was also one of the companies, AAA Trucking, which is—they broke down three different categories. Workmen's compensation, over the last 3 years, has gone up 211 percent. The general liability has gone up, over the last 3 years 342 percent, with a 50-percent increase in the deductible amount. In fire insurance, for the same company, AAA, the increase over the 3-year period of 150 percent with a 400-percent increase in the deductible amounts.

Now, what this means, it means to us as the Teamsters, we have jobs out there that we are losing. We are losing jobs every day because there are, as the Congressman said, companies that will no longer underwrite our people or use businesses or they find it economically impossible to stay in business. There are companies that have told employees that get involved in any kind of moving violation in a 3-year period, that they will cancel the insurance. Now, this is a little bit of a double jeopardy because, as you know, the person is, No. 1, if he has a moving violation, a speeding ticket or such, he is going to pay through his own personal car insurance, and now his employer is also threatened with losing his insurance if he keeps this person in his employ.

We have a company right here, a trucking company right here in Norwalk, Valleries Transportation. For the last 2 years, Valleries has lost hundreds of thousands of dollars. They were right on the brink of going under. They came to the union and asked for relief. We gave them relief with economic wage freezes and so forth, and, basically, what it came down to was last year, Valleries Transportation lost $200,000, but their insurance increases were $450,000 over the previous year or, basically, that company could have made a quarter million dollar profit, instead they did not.

I thank you for the opportunity to be heard.
[Addition to testimony follows:]

AFFILIATED WITH INTERNATIONAL BROTHERHOOD OF TEAMSTERS, CHAUFFEURS, WAREHOUSEMEN AND HELPERS OF AMERICA

SHIP UNION • BUY UNION • BE UNION

Teamsters, Chauffeurs, Warehousemen and Helpers Union No. 191

ANTHONY G. ROMEO
Secretary-Treasurer

1139 FAIRFIELD AVENUE • BRIDGEPORT, CONN. 06605 • PHONE 203-368-0231
1-800-972-9328

March 31, 1986

The Honorable Nicholas Mavroules
United States House of Representatives
Committee on Small Business
Subcommitte on General Oversight and the Economy
B-363 Rayburn House Office Building
Washington, D.C. 20515

Dear Representative Mavroules:

I would like to take this opportunity to thank you for letting my representative, Joseph Bennetta, go on record before your committee hearing which was held in Stamford on March 24, 1986. I was sorry that I was unable to attend, but a conflict of scheduling prevented it.

While the hearing was primarily for product liability in the trucking industry, our product is our trucking services. Enclosed you will find copies of responses from just a few of our employers who are being crushed by the heavy burden being forced upon them by the insurance industry. These samples, along with testimony heard by your committee raises two very important questions; How will business survive, and how long will it take before the crisis is into the homes of the employees, my members and your constituents?

To some degree the crisis is already there by way of consumer costs. Opponents of organized labor sight the cost of labor being the cause for many industries moving to foreign countries. I ask you, what company can compete with imports while having to pay these types of insurance premiums? With Teamster members there is a double jeopardy. A driver that receives a summons for a moving violation is immediately pummelled with an exorbitent increase in his auto insurance. Then, the employer's insurance is increased by their insurance carrier because they employ this individual. When will these inequities end?

The answer is not to penalize the victims, as they can least afford it. Limitations of attornies contingency fees and a mild form of federal regulation would give minor relief. But, this is not the complete solution. The solution is to treat insurance companies as they were intended to be; A protection against mishaps or catastrophy. In essence, a utility. Insurances should not be in the banking, real estate, or stock market business, but in the insurance business with premiums and proffts reflective of only the protection they afford.

I implore you and your committee not only to continue in your fact finding mission, but to seek out a prompt solution to this wide spread problem.

I would be interested in hearing any comments or responses you might have in this matter.

Very truly yours,

Anthony G. Rossetti
Secretary-Treasurer
Teamsters Local 191

AGR/dld

Enclosures

AFFILIATED WITH INTERNATIONAL BROTHERHOOD OF TEAMSTERS, CHAUFFEURS, WAREHOUSEMEN AND HELPERS OF AMERICA

SHIP UNION • BUY UNION • BE UNION

Teamsters, Chauffeurs, Warehousemen and Helpers Union No. 191

ANTHONY G. ROSSETTI
Secretary-Treasurer
30

1139 FAIRFIELD AVENUE • BRIDGEPORT, CONN. 06605 • PHONE 203-368-0231
1-800-972-9328

December 13, 1985

Healy Hauling & Rigging Company
547 Hope Street
Stamford, CT 06907

Gentlemen:

It has come to my attention that the Insurance Industry has been increasing their premiums on our Employers anywhere from 100% to 500%.

I am writing this letter to each and every Employer in Teamsters Local 191 asking that they give me their percentage of insurance increase that you have received from last year to this year, be it trucks, cars, vans, or buses.

It is my intention to compile all these figures, then write to the six (6) Congressmen/women and two (2) Senators from the State of Connecticut requesting an investigation and inquiry into these exorbitant insurance increases that you have been burdened with.

If you have any questions, please feel free to contact me.

Very truly yours,

Anthony G. Rossetti

Anthony G. Rossetti
Secretary-Treasurer
Teamsters Local 191

AGR/dld

Longshore Peggy

Liability Insurance 90%

Comp (Workmans) 39%

SHIP BY TRUCK

ART LOU TRUCKING INC.

WOOD END ROAD • STRATFORD, CONN. 06497
PHONE: 378-7341 · 378-7342
"SERVING ALL POINTS IN CONNECTICUT"

December 19th 198[illegible]

I B T Local #191,
1139 Fairfield Avenue,
Bridgeport. Conn 06605

Att: Mr A Rossetti,
Re : Insurance Charges.

Dear Sir,

We are in receipt of your letter re the increase in Insurance Premiums and after a consulation with our broker yesterday re renewal due 1/1/86, we find we are faced with a 45 to 50% increase.

There is no increase in coverage in fact a decrease in some areas even tho we have had a good record as far as losses are concerned. We feel that your proposal is a very good idea as tho the Motor Transport Assoc has tried to approach the Insurance Commissioner nothing has been done and in order to operate as you know we must have insurance. We wish you success and trust you will get the cooperation you are asking for.

Yours truly,
ART LOU TRUCKING INC.,
Louis A. Rossi
President

AMB/ss

Chevron

Hoffman Fuel Company
100 Southfield Avenue, Stamford, CT 06904 • Phone (203) 324-6143

Hugh Pickering
Manager

December 23, 1985

Mr. Anthony G. Rossetti
Teamsters Local 191
1139 Fairfield Avenue
Bridgeport, CT 06605

Dear Mr. Rossetti:

In response to your request for information on insurance rate increases, we are self insured and, consequently, have no factual data to provide.

Your interest in this matter is appreciated and is another indication of your interest in our industry.

Sincerely,

Hugh Pickering

STAMFORD WASTE SYSTEMS
89 JEANNE COURT • STAMFORD, CT 06903 • (203) 323-4744

December 23, 1985

Dear Mr. Anthony G. Rossetti:

This is in regards to your letter on the rates of the increase of our insurance company. The new increase is 19 %.

Yours truly

Michael Ferro Jr.

PETER MITCHELL
CONSTRUCTION LEASING & DEVELOPMENT CORP.

333 PALMER HILL RD.
RIVERSIDE, CT 06878
(203) 964-9221

December 24, 1985

Mr. Anthony G. Rossetti
Secretary-Treasurer
Teamsters Local 191
1139 Fairfield Avenue
Bridgeport, CT. 06605

Gentlemen:

With response to your letter dated Dec. 13, 1985, regarding auto and truck insurance, the difference between our 1984 and 1985 insurance was a 30% increase.

Thank you for your interest in the matter.

Merry Christmas and Happy New Year to all!

Very truly yours,

PETER MITCHELL CONSTRUCTION,
LEASING & DEVELOPMENT CORP.

Frederick G.C. Smith III,
Vice President

CHESTNUT HILL
BUS CORPORATION
CHARTER & SCHOOL BUSES FOR HIRE

RALPH R. ARGANESE
PRESIDENT

Please reply to:
Bridgeport

December 27, 1985

Mr. Anthony Rossetti
Secretary-Treasurer
Teamsters Local 191
1139 Fairfield Avenue
Bridgeport, CT 06605

Dear Mr. Rossetti:

I have received your letter dated December 13, 1985, regarding the insurance crisis we are presently facing. I am hopeful that once you have received the information, that with your help and the help of the transportation industry sticking together, we can find some relief from these exhorbitant increases.

We were cancelled two months before the expiration of our policy with only a thirty-day notice. Our liability insurance increased 300% across the board, amounting to an increase in premium of $400,000.00 in one year. I might add that this increase in premium covered only one-third of the coverage I previously had. We presently have $5 million per accident, and in prior years, we had $15 million per accident.

If there is any additional information you might need to investigate these increases, please feel free to call me anytime.

Thank you.

Very truly yours,

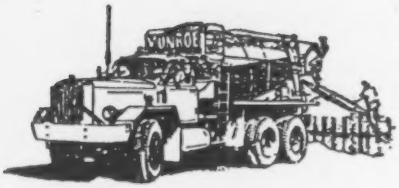
Ralph R. Arganese
President

RRA:eke

• 300 ORLAND STREET
PO. BOX 3358
BRIDGEPORT, CT 06605
(203) 333-5155

• 100 HEMINGWAY STREET
NEW HAVEN, CT 06513
(203) 468-6988

• 122 SELLECK STREET
STAMFORD, CT 06902
(203) 325-8538



Monroe Ready Mix Concrete, Inc.

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Fairfield County's Largest Installer of Foundations
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Mailing Address:
Post Office Box M
Rt. 25, Monroe, Conn. 06468

Phones: 261-3611
426-9900
261-3612

January 1, 1986

Teamsters Local #191
1139 Fairfield Ave.
Bridgeport, Ct. 06605

Anthony Rossetti,

Per your request of December 13, 1985, in reference to rising insurance rates. In the past year our insurance premiums have risen 44%.

We support your position, and we are pleased to contribute this information.

Very truly yours,

Mark Rea

TEAMSTERS, CHAUFFEURS, WAREHOUSEMEN & HELPERS UNION
JAN - 6 1986

THE DE FONCE CONSTRUCTION CORPORATION

ENGINEERING CONTRACTORS

110 Colonial Avenue

P.O. Box 6337 — Bridgeport, Connecticut 06606

January 2, 1986

Mr. Anthony G. Rossetti
Secretary-Treasurer
Teamsters Local 191
1139 Fairfield Avenue
Bridgeport, CT 06605

RE: Mianus River Bridge I-95
Project #56-200

Dear Mr. Rossetti:

We have received your letter dated December 13, 1985 in our office on December 19, 1985.

Our insurance increases are the following:

$5,000,000.00 increase in our Umbrella Insurance

1982	-	$ 2,250.00
1983	-	2,850.00
1984	-	3,650.00
1985	-	164,715.00

An increase of $161,065.00 for Umbrella only or 44½ times = 4,400%

Liability

Work on hand $9,350,000.00. Paid in 1984 $12.00 per $1,000.00. Paying in 1985 $25.00.00 per $1,000.00 or an increase of approximately 110% or $112,220.00.

Trucks, Cars, Equipment - approximately 65% increase.

To date plus compensation our increase in insurance will cost $454,000.00

Our trucking is being done by the following firms:

1. Ryan Trucking Co., North Haven, CT.
2. Riccardi Brothers, Greenwich, CT.
3. Dyn-o-mid Co., Stamford, CT.

JAN - 1986

4. Compo Brothers, Stamford, CT.

5. Don Moffo, Prospect, CT (W.B.E.)

6. Telesco Fuel & Masons Material Co., Stamford, CT.

7. Gardella Trucking, Norwalk, CT.

In conclusion the job will be shut down for January, February, and March of 1986 partly due to the high insurance costs.

Very truly yours,

THE DE FONCE CONSTRUCTION CORP.

Thomas J. De Fonce
President

TJD:ska

cc: lb, bpt., engr.

TRUCKING
Since 1921
3830 QUAKERBRIDGE ROAD • P.O. BOX 8042 • TRENTON, NEW JERSEY 08650-0042 Tel. 609/586-0700

January 2, 1986

Mr. Anthony G. Rossetti
Secretary-Treasurer
Teamsters Local #191
1139 Fairfield Avenue
Bridgeport, CT 06605

Dear Tony:

Thank you for your letter dated December 13, 1985.

Your attention to the subject is most appropriate. Aside from the many factors ravaging this industry, brought about primarily by deregulation, this situation with insurance is probably the most ominous. In addition to sucking the lifeblood of the industry, this problem threatens to extend itself beyond the workplace into the homes of our employees and their families--your members.

Attached you will find the information you requested. Any assistance you can give us in this regard is greatly appreciated. Thank you.

Should you require more detailed information please feel free to contact me.

Respectfully,

AAA TRUCKING CORPORATION

Enrico G. Moscatello/jm

Enrico G. Moscatello
Executive Vice President
Company Operations

EGM:mjc
Attachment

cc: G. M. Bonacci

P.S. Attached you will find two articles that will appear in the company newsletter.

RECEIVED
TEAMSTERS CHAUFFEURS
WAREHOUSEMEN & HELPERS
UNION NO. 191
JAN - 6 1986

% INCREASE IN INSURANCE PREMIUMS OVER THE PAST 3 YEARS

		83-84	84-85
1.	Worker's Compensation	41%	120%
	Increase over a 3 year period = 211%		
2.	General Liability	13%	290%
	Increase over a 3 year period = 342% (with a 50% increase in the deductible amount)		
3.	Fire Insurance	100%	25%
	Increase over a 3 year period = 150% (with a 400% increase in the deductible amount)		

Insurance Companies Play Rate Roulette

The Interstate Commerce Commission now realizes the seriousness of the insurance situation facing American trucking companies. That's why on Oct. 31 it formally opened an investigation into the current insurance crisis in the industry.

Companies like AAA Trucking Corporation have been aware of the problem for quite some time. The American Trucking Association has been pressing for such an investigation, and the ATA publication, "Transport Topics," has followed developments in this area for months.

In fact, the ICC investigation is attributable primarily to efforts by the ATA.

Recently, "Transport Topics" reported that the ICC has been forced by the crisis to revoke the operating authority of almost 3,400 motor carriers "because of inadequate insurance coverage during the past two years." ICC Chairman Reese H. Taylor, Jr. has placed the insurance probe "on a very fast track" because of its importance.

The ICC also took note of the fact that on Sept. 17, New Jersey Gov. Thomas Kean declared a "commercial liability insurance crisis" in New Jersey, AAA Trucking Corp.'s home state. The New Jersey governor's order calls for a moritorium on insurance companies writing a total of several billion dollars in policies. They may not renew, cancel, or impose rate increases on these policies until further notice. All motor carriers in New Jersey covered by those companies are affected.

In making its announcement, "Transport Topics" reported the ICC as declaring that "the economic and operational viability of many carriers may be threatened by this situation. Motor carriers of property and passengers have faced significant increases in premiums to retain existing property and bodily harm insurance coverage," sometimes the increases are as high as *1,000%*.

It is also true that some carriers have been forced out of business or are operating without insurance, and others have not been able to compete or enter new markets because of the crisis.

According to AAA Trucking Corporation Vice President/Sales Joe Mitchell, increases of several hundred percent are not uncommon in today's motor carrier insurance environment.

The ICC, through the investigation, will try to determine the extent of the current crisis, its causes, and explore what can be done to alleviate the situation.

Several months ago, the ATA noted that "*motor carriers are not only finding the congressionally mandated insurance (policies) more expensive, they are also more difficult, or impossible, to obtain.* Those carriers who are able to obtain insurance are often faced with serious delays in acquiring the coverage required. When insurance is available, it is at a highly inflated rate." ■

Premiums Likely to Continue Climb

While the Interstate Commerce Commission investigates the trucking insurance crisis, it's likely that insurance rates will continue to rise.

That was the indication that came out of the 52nd annual convention of the American Trucking Association, and the seminars held in conjunction with the annual meeting.

Speaking on "Meeting the Insurance Crisis Head-On," Transport Insurance's Mike McCray warned that "the public does not like the way trucks are being operated and lawyers are aware of this and the courts are responding."

In trying to explain why rates are rising, McCray said premiums are likely to keep going up. And just as the trucking industry is beginning to cope with this, there's another cloud looming over the horizon. Referring to this cloud, Jay Deragon, of Insurance Management Corp., was reported by "Transport Topics" as saying that motor carriers should check their policies carefully because they may be "running naked" where potential environmental pollution violations might occur.

The insurance executive chided carriers for not taking a closer look at what they are hauling. He said they should ask themselves: "Is it worth hauling, considering the insurance rates or total exclusion from coverage?"

He also cautioned that a policy issued before June 1985 will have a sizeable increase tacked onto it when it is renewed in 1986. He said policies will have more restrictions on them and coverage will be less broad. ■

Country Home BAKERY INCORPORATED

1700 Barnum Ave., P.O. Box 2327
BRIDGEPORT, CONNECTICUT 06608-0327
Telephone (Area 203) 333-2151

January 6, 1986

Mr. Anthony G. Rossetti
Secretary-Treasurer
Teamsters Local 191
1139 Fairfield Avenue
Bridgeport, Connecticut 06605

Dear Mr. Rossetti,

As you requested in your letter of December 13, 1985 our commercial vehicle and property insurance has increased on average over 40% in the past year.

Your efforts and support in this issue, are very much appreciated.

Yours very truly,

Charles R. Cullen

Charles R. Cullen
Comptroller

CRC:es

ARMENTO, SMEDLEY & HELFER
JAN - 9 1986

ROADWAY
EXPRESS, INC.

460 STERLING ST.
CAMP HILL, PA 17011
717-761-2700

January 6, 1986

Mr. Anthony G. Rossetti
Secretary-Treasurer
Teamsters Local #191
1139 Fairfield Avenue
Bridgeport, CT 06605

Dear Tony:

I have received your letter of December 17, 1985 concerning the rising costs of insurance involving the transportation industry as a whole.

I am afraid Roadway Express, Inc. cannot help you in this area due to the fact we are "self-insured." The facts or figures we have in our records would be of no use to you in your quest.

I certainly thank you for your concern in this important matter and would like to take this opportunity to wish you and the boys a Happy New Year and continued success in your endeavors.

Sincerely yours,

G E Mutschler

George E. Mutschler
Assistant to Vice President-Labor
Roadway Express, Inc.

GEM:fjc

WEST END MOVING & STORAGE CO., INC.
241 PINE STREET, P.O. BOX 3374
BRIDGEPORT, CONNECTICUT 06605-0374
I.C.C. No. MC-109887

Bridgeport 367-4481
Westport 227-7366

Stamford 322-3425
New Haven 865-1451

January 10, 1986

Mr. Anthony G. Rossetti
Secretary-Treasurer
Teamsters Local 191
1139 Fairfield Avenue
Bridgeport, Connecticut 06605

Dear Tony:

Apologies for the delay in responding to your inquiry of December 13, 1985 concerning the percentage of increase we have experienced in our insurance coverage.

We have just renewed and I have listed below the percentage figures which are astronomical.

Our public liability, property damage, workers compensation insurance, etc. is up 75% over the previous year.

Our excess liability (umbrella coverage) is up 455% over last year. This last amount is staggering and we do not know how we are going to be able to handle this type of increase within the framework of our tariff charges.

I think it is most important that all concerned realize the "beating" the trucking industry is taking from the insurance carriers this year and the burden we must bear.

Should you have any questions, please call me. I think what you are doing is very worthwhile and we certainly appreciate it.

Lets hope something positive comes of it.

Sincerely yours,

John S. Kartovsky
President

JSK:nlh

cc: Shelly Levine, West End Moving

Len Toigo, West End Moving

Mohican Valley
CORPORATION
301 STATE STREET EXT. — FAIRFIELD, CONN. 06430
Phone
366-7971

February 14, 1986

Mr. Anthony Rosetti
Teamsters Union No. 191
1139 Fairfield Ave
Bridgeport, CT 06605

Gentlemen:

I am writing in response to your letter of December 15, 1985.

Please be advised that our insurance has increased approximately 110% for the policy year 1986 to 1987. It had increased approximately 110% for the policy year 1985 to 1986. Thus making a total increase over the last two policy years of approximately 400%.

Sincerely,

Jill Toma

Jill Toma

file

MALLOZZI CONSTRUCTION COMPANY

Excavating Contractors

89 SAGAMORE TRAIL - NEW CANAAN, CT 06840
203 323-1891

February 20, 1986

Mr. Anthony G. Rossetti
TEAMSTERS LOCAL 191
1139 Fairfield Avenue
Bridgeport, CT 06605

RE: INSURANCE INCREASE '85 - '86

Dear Mr. Rossett:

Our percentage of increase over-all was 125% higher than previous year. We did not have an increase in coverage, our insurance carrier is the Aetna Casualty Company.

Needless to say, we were totally shocked at this exorbitant unrealistic increase. Any assistance which you feel would help in this situation would be appreciated.

Maybe a "mailer" to all employers of your letters to various State officials for our signatures would help. In this way with so many requests coming in for an inquiry maybe something can be done.

Very truly yours,

MALLOZZI CONSTRUCTION COMPANY, INC.

Toni S. Mallozzi

Toni S. Mallozzi

WAREHOUSEMEN HELPER
UNION
FEB 24 1986

Mr. MCKINNEY. I would like to say, Mr. Chairman, I thank all of this panel, since we have sort of run out of time. We have two other gentlemen that would like to say that they are here and have problems. We will keep the record open and let them——

Mr. MAVROULES. Especially Ms. Gay. I am going to keep the record open so that you may give more testimony. I would like to know more about your own particular case through your attorney. If he could send me a copy of any information that you might have, send it to Congressman Stewart McKinney.

The record will be open. I invite you to give whatever information you could to us.

Mr. MCKINNEY. Mr. Chairman, I should point out that I have a son whose eye is missing, because of an accident. Since he was a minor at that point, though he is a married school teacher now, I led him into a lawsuit, and it was like being hit by a buzzsaw in Portland, ME. Trying to get some money for the loss of his eye turned out to be impossible. The interesting part about the lawsuit was that I finally turned to Ford, who won it most successfully, with more power than I have ever seen to fully defect the Nazis in World War II, and I said to them, "Why do you have all this?" I said to Ford, "Are you on a retainer?" Well, why are we under retainer? Because we cannot possibly, Ford Motor Car Co. is a great big company, we cannot possibly get the kind of insurance it takes so that in every LTD you buy and every Escort you buy, there are *x* number of dollars written in to protect us in all 51 jurisdictional areas of this Nation. This thought is mindboggling. Let us put it that way.

I do not know how you people even work, and Lou Vallerie has been a friend of mine for years, and I just absolutely shudder, shudder.

Mr. MAVROULES. We have been listening to these horror stories up in Washington. I get them back in Massachusetts. I hear them all, but I want to know something else, and I have got to come back to you——

Mr. BIEDER. Sure.

Mr. MAVROULES [continuing]. Because you are an attorney. Many people are blaming you, and they are calling you power hungry and money hungry. When I say you, I am referring to the attorneys throughout the country.

Mr. BIEDER. I took it that way.

Mr. MAVROULES. Well, you are an up front gentleman, and I want to be up front too. We are trying to weigh what the problems are here. Many people are saying the lawyers are hungry, they will use clients, they will grab about 30 to 40 percent.

How do we respond to that kind of a case? What is the average take for an attorney in this kind of a case?

Mr. BIEDER. The only study that there is that I am aware of is a Federal study done about 7 years ago, which says that the average plaintiff's attorney, the average amount of fee, and it is all done on contingency, and I will get into it for a minute why I think the insurance industry wants to do away with the contingency fee, the average is 28 percent.

What happens now is it is completely between an attorney and a client to negotiate what that is. I do not hear any clients resisting

the contingency fee or the amount of contingency fee that we have set with our clients, and it varies, depending on the nature of the case.

I do not hear any client complaining. The only people that I hear complaining about it, the only people are the people in the insurance industry, and people through whom they speak and through whom they have gotten to buy the argument that contingency fees are no good, and those are all the people who can afford and do hire lawyers on an hourly basis.

Mr. MAVROULES. I just wanted some kind of a response to what I am hearing out there.

Mr. BIEDER. As a matter of fact, the town of Trumbull would not have been able to bring its lawsuit that it just brought were it not for the contingency fee, and as I suspect, the kinds of lawsuits the insurance industry wants to head off.

Mr. MAVROULES. OK. Michael, do you have a quick comment to make?

Mr. NOONAN. Yes. One quick comment.

I was a member of the Governor's task force, as was Mr. Rathgeber, and we, the AFL–CIO, cast a lone "no" vote among the 25 members of the task force on the final report.

I also served on the law review subcommittee. They came out with a recommendation in regards to contingency fees. During the discussion and vote on that recommendation, there were questions raised about the cost in regard to defense. The attorneys that are on retainer, or are being paid on an hourly basis, and it was ruled by the chairman that that was inappropriate to be included in the recommendation and final report, so that it only addressed contingency fees, although I have a feeling we are not looking at the total picture.

There was a bill in Georgia in which, when an amendment was offered to cap legal costs across the board, the defense lawyers association was the most vocal activist to kill the bill in total. So, if you want to look at it, let us look at it that way.

Mr. MAVROULES. Yes; thank you all very, very much for your testimony.

Mr. MCKINNEY. Mr. Chairman, we have Joe Schachter, who is responsible for the fact that people are sitting instead of standing on the way to New York, and we have Ed Campbell here, and we have no time. We sort of ran out of it, but I would like any information you have as to costs of your insurance and then we will keep the record open.

Mr. MAVROULES. We will keep the record open. Why don't you come right up here? We have about 3 or 4 minutes.

Mr. MCKINNEY. Why do we not take the two together and get them both up here? Can you get insurance and how much will it cost, and then we will let you flesh out our record here.

Mr. SCHACHTER. I am not quite sure what you want us to say or how you want us to proceed, Mr. Congressman.

Mr. MCKINNEY. Well, I am assuming that you are either having trouble getting insurance or it has gone out of sight.

Mr. SCHACHTER. Yes; in other words, you want us to——

Mr. MCKINNEY. Just summarize and your statement will be put in the record.

Mr. SCHACHTER. OK. I have a statement, very brief, which is just in outline form.

Mr. MCKINNEY. Very good.

Mr. MAVROULES. By keeping the record open, we give you the opportunity to give us your full statement for the entire hearing. That can be forthcoming down the line.

Mr. SCHACHTER. I have no statement. I just have some notes.

TESTIMONY OF JOSEPH SCHACHTER, PRESIDENT, CONCRETE FLOTATION SYSTEMS, SOUTH NORWALK, CT

Mr. SCHACHTER. My name is Joseph Schachter. I am president of Concrete Flotation Systems in South Norwalk, CT.

I would like, first, however, to speak from 30 years of experience in the advertising industry. Ten years ago or less than that, I was a vice president of the J. Walter Thompson Co.

You asked the question before about shoddy merchandise and shoddy manufacturing. I must say that any Fortune 500 company or any larger company cannot survive if they do not make a good product. We know in the advertising industry, we can get people to buy that product once, but no large corporation will ever survive in this or any other country unless that product could be resold a second, or third, or fourth, and a fifth time.

So, the best protection we have is making good products. If there are shoddy products or shoddy manufacturers who are against various legislation, they are small and they are not going to be around very long. So that question, I do not think, impacts on your deliberations.

Frankly, when you talk small business, you are talking companies that are under $500 million, as I recall, in the definition.

Mr. MCKINNEY. Too high.

Mr. SCHACHTER. Well, I am not a small business. I am not even a tiny business, because a tiny business by Government definition would be less than $17 million. I am an infinitesimal business. I am under $5 million. Way under, and I am not going to tell you how much because I am privately held and I do not have to tell you, but I am way below——

Mr. MCKINNEY. I was way under, too, and I thought I was pretty big stuff.

Mr. SCHACHTER. We are on the same level in that regard or were at that time.

I am in the area where management puts in 60 to 90 hours a week trying to keep it going. I resent the fact, and I say this with sincerity rather than criticism, that 5 percent of my work week has been left here this morning.

I do not have time to worry about my insurance. I have a docket that thick, which is my insurance. I have been planning to read it now for 2 years, for 3 years.

Now, I was expecting the bill last October. It came in just 3 weeks ago, with another pile that thick. Way up, up 46 percent, and they have not written it all yet. There is more to come.

I have tried to put that into some kind of framework. What does that mean to my company? Forty-eight percent increase. Well, with

the same money that I am spending for insurance, I could increase my staff in the office by 15 percent.

Now, if you say that a salesman gets 5 percent—I am not saying that my salesmen get 5 percent, I do not know what other industries use as commission rates, but let us say 5 percent—that means that my insurance bill is worth a half a million dollars in sales. Half a million bucks in sales. That is getting big.

What it is doing to me, because I have had tough sledding. I started the business during high interest rates and could not get capital that I needed. I now watch the dollar get to be very expensive, so that imports are hitting us from all directions. We now find that our biggest competition is not here in this country and there are a dozen of us. It is coming in from Canada. Even the Swedes have closed down their operations in Sweden and started-up in Canada because of favorable rates.

When we go to sell a project and find it has gone to Canadian competition and the reason it went is not because of better product, but it went because the Canadian Government is picking up the paper, then you really have a tough time. This impacts on that.

I would like to sum up by saying that it seems like nothing happens to us in this country unless a crisis occurs. When the taxes got too great back in the 1700's, we had the Boston Tea Party. Transportation in 1959 got so bad, it took 2 and 3 hours into New York City, when it used to take an hour. We got to a crisis situation, and the Honorable Mr. McKinney and I were represented before the ICC, and I will never forget seeing my name on that with yours and almost dying.

What happened to the Penn Central that went bankrupt? Here is what happened: Today, they are in the real estate business, and that is a parallel to what we are facing in many respects with the insurance industry.

The insurance industry in the last 10 years has not been in the insurance business. It has been in the business of collecting premiums and using that capital to build their own profits.

I am not aware of all the ramifications. I heard more this morning than I ever wanted to know about the industry, but it seems very apparent—very apparent to me—that the tax laws must be reviewed to get the insurance business back into writing insurance and dedicating themselves to the insurance industry rather than using those premiums to increase their net worth.

Mr. McKINNEY. Joe, I am afraid we are out of time. So, anything else you want to say——

Mr. SCHACHTER. Just one thing.

Mr. McKINNEY [continuing]. If you want to write us something, go ahead.

Mr. SCHACHTER. It is a utility and should be managed the same way.

Mr. MAVROULES. Thank you very much, Mr. Schachter.

Mr. McKINNEY. Mr. Campbell.

TESTIMONY OF ED CAMPBELL, E.W. CAMPBELL ARCHITECTS, WESTPORT, CT

Mr. CAMPBELL. My name is Ed Campbell from E.W. Campbell Architects, a proprietorship.

I have been in business 12 years as an architect in the State of Connecticut. I am licensed in 7 States and practice in 7 States.

Most recently, my liability insurance doubled again. In 1984—before then, it was consistent—around $1,800 a year for $100,000 in coverage, and $5,000 deductible. In 1984, $1,800; in 1985, $3,798; in 1986, $6,922.

I had to raise my rates the first time in the history of my firm $3.50 an hour for the principal time to offset that cost. That is an increase of 100 percent this year.

When the anniversary date of that renewal changed, I had less than 30 days to raise that money—that capital. I had to get a note from the bank. When I went into the bank, he says you are not alone. I have a man waiting behind you that needs $60,000 on a $10,000 original beginning in the professional practice area.

I now pay $10,000 deductible for $100,000 worth of coverage. I do billings in the size of $1 million plus. I cannot get $1 million or better coverage. Material Casualty Co. said to me, if you want more coverage, we will give you $250,000 worth of coverage, Mr. Campbell. It will cost you $20,000 with a $20,000 deductible. I cannot afford that.

Worse than that, they put on an endorsement this year that limits the coverage for the lawsuit of the case only, not the litigation. Therefore, I now have to pay the legal fees. They said sign it or lose your coverage. I had no time to investigate other areas. I signed it.

They also have eliminated asbestos coverage; therefore, the Federal Government has said you must eliminate asbestos from our schools. The State of Connecticut puts out a bid for architectural services to remove asbestos. We cannot get coverage in the State of Connecticut, so who is going to remove the asbestos?

I am a proprietorship. I have six employees, and last year I grossed $400,000 in fees. You cannot believe 7½ percent of my fee structure goes for insurance.

Mr. MAVROULES. How much?

Mr. CAMPBELL. Seven and a half percent. I paid $30,000 in insurance coverage, medical, life, protecting my firm, if I pass away, truck, like that.

I also have a company called Liberty Mutual Insurance, general liability. If you walk out my door and trip on the sidewalk, I have $100,000 worth of coverage, and it has been very reasonable over the years.

They gave me a notice of cancellation on March 19, effective May 1, because I am acting as a construction manager. I have been acting as a construction manager along with my practice for over 10 years. I do not know where I am going to get coverage and what it is going to cost me, and I want to do something about it, and I thank you for asking me here because that is one of the main reasons I am here.

Mr. MCKINNEY. Thank you both, and if you have any more notes, send them in.

Mr. MAVROULES. Oh, yes. The record will be open.

Mr. MCKINNEY. You probably heard me earlier. I do not know if you were here when I stated that for 3 weeks we worried about liability for the Stamford Railroad Station, which is a sore on all our bodies, and a particularly political one at times, and, so, we finally self-insured, and it took a great deal of effort to get the Federal Government to say: Well, we will do it anyway. We will just have to watch ourselves, but that is the case, and I think when an engineering firm is of the caliber and the quality we were demanding with a review firm behind it, in your line of business, we certainly should be able to get liability insurance, though we cannot.

Mr. MAVROULES. Stew, this has been an excellent hearing. I am delighted with the people who turned out here today, and I want to thank you and your staff for cooperating.

Mr. MCKINNEY. We are delighted having had the great State of Massachusetts descend to our lower levels here.

Mr. MAVROULES. We have similar problems, my friend.

The hearing is closed, and thank you all very much.

[Whereupon, at 12:45 p.m., the subcommittee adjourned, to reconvene subject to call of the Chair.]

APPENDIX

Appendix A.—Additional Material Submitted by Thomas S. Chittenden, Senior Vice President and General Counsel, American Insurance Association

INSURANCE AVAILABILITY

An Industry View

Alliance of American Insurers
American Insurance Association
National Association of Independent Insurers

Orginally Issued
December 6, 1985

Revised
February 24, 1986

INTRODUCTION

For the first four years of this decade, most buyers of commercial and professional liability insurance enjoyed stable or decreasing insurance premiums. Then, in early 1985, premiums turned upward, often precipitously, and some buyers found it difficult to obtain adequate coverage at prices they regarded as affordable. The "availability crisis", so called, has been extensively covered by the media, and there have been proposals from many quarters as to what to do about it, ranging from voluntary efforts by insurers and agents to fundamental tort reform.

The insurance industry believes that it is critically important that efforts to solve availability and affordability issues be grounded in a sound understanding of the private insurance mechanism and the impact that the liability system* has on it. Accordingly, this paper describes the reasons for the recent escalation in commercial and professional insurance premiums and sets forth seven actions, some voluntary and some requiring regulatory or legislative approval, that can lead towards an easing of problems of availability and affordability. The paper also cautions that ill-conceived measures, such as a return to administered pricing or the adoption of involuntary market mechanisms, may impede the return of the insurance industry to financial health and thus operate to the detriment of consumers in the longer run.

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*As used in this paper, "the liability system" means the whole panoply of substantive and procedural rules by which losses are transferred from one party to another. It also includes the mechanisms through which disputes are resolved in court or otherwise, including judicial decisions with respect to insurance contracts.

Together, the Alliance of American Insurers, the American Insurance Association and the National Association of Independent Insurers (hereinafter called "the trades") represent 841 companies that write 60% ofall direct personal and commercial lines premiums in the United States and 62% of all commercial lines premiums.

The trades acknowledge the extensive help of the Insurance Services Office in providing information and statistics for this paper, and in consulting generally as to its contents.

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FINANCIAL RESULTS

1984 was the worst year ever for the U.S. property-casualty insurance business. Pre-tax operating income (the combination of investment income and underwriting results) plunged to a negative $3.8 billion. The 1984 financial result was the culmination of an unbroken string of underwriting losses that began in 1979. Underwriting losses grew at an average annual rate of $3 billion through 1983 and then jumped by $8 billion in 1984. Total underwriting losses for the 1979-1984 period were $55 billion.

Until 1983, growing investment income, fueled by high interest rates, was able to offset underwriting losses. But in 1984, a modest 10.6% increase in investment income ($1.7 billion) was not able to overcome a substantial increase of $8 billion in underwriting losses, and the industry sustained the largest net operating loss in its history.

In 1984, there were underwriting losses of $16.8 billion in commercial and professional lines. These losses were 79% of all underwriting losses in 1984, whereas premiums for commercial and professional lines were only 51.3% of total industry premiums. In contrast, personal and commercial lines have historically had closely parallel loss ratios.

General liability (combined ratio:* 152) and medical malpractice (combined ratio: 170) were especially hard hit. The combined ratios mean

*The combined ratio is the ratio of incurred losses, loss adjustment expenses and policy holder dividends to earned premiums plus the ratio of underwriting expenses to written premiums.

that actual expenditures and incurred obligations exceeded earned premium income by 52% and 70%, respectively, in these lines. Total underwriting losses in 1984 were $3.2 billion for general liability and $1.2 billion for medical malpractice. These underwriting losses of $4.4 billion for general liability and medical malpractice were 21% of all underwriting losses in 1984, whereas premiums for these lines were only 7% of total industry premiums. Under the most optimistic assumptions, investment income available in the market today falls far short of making up underwriting losses of this magnitude.

In 1983 and 1984, reinsurers were hit even harder by losses than the direct market. Historically, reinsurers' combined ratios closely paralleled those of the industry as a whole. In 1983, however, reinsurers had a six point higher combined ratio than the direct market (118 as opposed to 112), and in 1984, the reinsurers' combined ratio was ten points higher (128 as opposed to 118).

Although the overall combined ratio for the industry declined from 118 in 1984 to 117 in 1985, and the combined ratio for commercial lines declined from 128 to 123 for the same period, the industry nonetheless sustained a net operating loss of $5.5 billion in 1985. This was nearly 45% higher than the net operating loss for the prior year.

THE CONSEQUENCES

These escalating financial losses had the following consequences:

- a decrease of 2.5% in the aggregate policyholder surplus of the industry in 1984.* This is an unsatisfactory situation because the industry must continually increase surplus if it is to be able to support the demands of a growing economy for insurance. In fact, a study by the Insurance Services Office projects a significant capacity deficit in the next three years, almost all of it in commercial lines.

- a plunge in the industry's annual rate of return on net worth to 1.7% in 1984. The rate of return on net worth was actually negative for 50 of the top 100 insurer groups. While the industry's annual rate of return recovered to 5% for the first six months of 1985,** it is still almost ten percentage points below the average rate of return for the Fortune 500 companies.

- the partial or total withdrawal of major reinsurers in the United States, Britain and Western Europe from difficult U.S. liability lines (for example, environmental pollution and asbestos containment contractors' liability).

- a significant increase in the number of companies found to be financially impaired. In 1984, regulators found 20 companies to be insolvent. In 1985, an additional 20 companies have become insolvent. In addition, companies representing more than 20% of industry's premiums have failed at least four "early warning" tests established by the National Association of Insurance Commissioners.

* Surplus increased by 12% in 1985 as the result of investment income that was 13% higher than in 1984 and new capital of $5 billion reflecting investor expectations of future profitability.

** Rate of return on net worth was approximately 2.7% for all of 1985.

In sum, severe recent losses have produced less capacity to write insurance and an increased number of companies that are insolvent or facing major financial difficulties.

The financial condition of the U.S. property/casualty industry in 1984 necessitated large and widespread premium increases in liability lines and reduced the availability of coverage for commercial and professional buyers. Underwriters also became more cautious in deciding what terms to offer to which buyers. In some liability lines, by the spring of 1985, liability insurance was not available at any price to some buyers in some lines of insurance, either through the admitted market or the surplus lines market. Buyers for whom availability has been particularly a problem in 1985 include: day care center operators; municipalities; nurse-midwives; toxic waste facility operators; and dram shops.

By and large, liability lines -- and especially those where shortages of capacity developed -- present the greatest risk of losses, just at the time when the commercial insurance industry desperately needs predictable, manageable business in order to create stability and reasonable profits as a basis for expanding its capacity.

In the 1980-84 period, as events turned out, insurance companies seriously underpriced their products. The warning signs were there as the frequency and severity of losses increased. But it took net losses in 1984 to bring home to the industry the absolute necessity of substantial price increases and selectivity in underwriting. In part, underpricing was due to the vigorous competition among insurers during that period for premium income to employ at high yields in financial markets. But the decisive factor in underpricing was the inability of underwriters to predict with any

degree of accuracy the losses they would eventually be required to pay. The expansionist, almost capricious nature of the liability system and the costs this would eventually entail were seriously underestimated by insurers.

EXPANSION OF THE CIVIL LIABILITY SYSTEM

As recently as twenty years ago, the tort law was a tightly configured system of rules under which losses were transferred from fault-free plaintiffs to clearly identified, negligent defendants. Causation was strictly construed, and latent injury claims were a thing of the future. The organizing principles of the liability system were the fairness of shifting losses where clear negligence could be shown and the general deterrence of others that was thought to result. Compensation of victims was important, but it was to be accomplished under a standard of fairness to all parties.

Today, things are far different. Negligence has been eroded or done away with as a standard, and assumption of the risk and contributory negligence have all but disappeared. Causation requirements have been overcome by judicial or statutory presumptions, and mass torts (usually with a long gestation or latency period) are now commonplace. In most areas of the country the size of jury awards has grown over the past ten years at a much greater rate than inflation, and the frequency of lawsuits has increased precipitously.

Individuals and groups differ as to the desirability of these changes. But their impact on the property-casualty industry is clear. Costs are way up and over time must be adequately reflected in premiums. More fundamentally, the industry has great difficulty in predicting its

losses and making adequate provision for them. The unpredictability and costliness of the liability system, as it has evolved, bear a direct relationship to the current problems with availability and affordability.

A detailed discussion of all of the changes in the tort system in recent years that have affected insurance availability and costs is beyond the scope chis paper. A few examples, however, will illustrate the scope and complexity of the problem:

- An "entitlement" psychology has become deeply rooted in American society. This encourages adversarial proceedings and a feeling that every "wrong", no matter how defined, should be put right by somebody.

- The Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA) imposes a regimen of strict, joint and several liability for the costs of toxic waste clean-up. Through judicial interpretation, CERCLA applies retroactively to conduct occurring before its enactment in 1980. Moreover, one or more defendants, among many potentially responsible, may be held solely or disproportionately accountable for damages through rigorous application of the doctrine of joint and several liability.

- There has been an erosion of traditional fairness doctrines that found liability based on what the defendant knew or should have known when he acted or failed to act (Beshada v. Johns Manville, 91 N.J. 191 (1982). In Beshada, a manufacturer was held liable even though its conduct at the time it performed met all of the best available scientific and technical standards.

- There has been a gradual shift from traditional requirements that responsibility must be proved against particular, identifiable defendants to theories of enterprise liability Sindell v. Abbott Laboratories, 26 Cal.3rd 588 (1980).

- Insurance contracts, have increasingly been ignored, even when the language is clear. The most egregious recent example is Jackson Township v. Hartford Accident & Indemnity, 186 N.J. Super.156 (1983), in which the pollution exclusion in a standard comprehensive general liability policy was read against clear policy language

and intent to include coverage for the gradual seepage of pollutants from the insured's land.

- Relative to indemnity to claimants, the costs of resolving disputes have risen astronomically. Illustrative of this is the growth in loss adjustment expenses, of which 90% are legal fees. As a percentage of damages, allocated loss adjustment expenses have risen from less than 15% in the late 1950s to almost 34% in 1983. A special ISO study indicates that costs may well approach 50% of the ultimate settlement value for claims reported in the last three years. A study by the Institute for Civil Justice finds that only 37 cents of every $1 expended in litigating asbestos claims reaches claimants.

INDUSTRY PROPOSALS

In the light of the expansion of the liability system, the insurance industry firmly believes that there will be no permanent and satisfactory solution to problems of insurance availability and affordability in commercial lines until changes are made in the liability system. From the perspective of the insurance industry, these changes must restore predictability to the process of assessing liability risks and permit the resolving of disputes more economically and expeditiously.

Until lasting, structural changes to the liability insurance system can be made, the industry recognizes that it has a responsibility to respond to the needs of the insurance-consuming public, both in decision-making by individual companies and in collective discussions on public policy issues with legislators and regulators.

In order to meet insurance availability and affordability problems in the short term and longer range, the Alliance of American Insurers, the American Insurance Association and the National Association of Independent Insurers offer the following seven proposals.

1. Reasonable Limitations on the Cancellation or Non-Renewal of Commercial Insurance Policies

The industry acknowledges the need for reasonable limitations that cover individual and block policy cancellations; notice of changes in policy terms; and notice of non-renewal. The industry believes that a reasonable balance should be struck between the buyer's need for stability and time to react if changes are necessary on the one hand, and the insurer's need for a degree of flexibility to respond to changes in the individual risk or impairments in the financial status of the insurer or its reinsurers.

2. Voluntary Market Mechanisms

Many in the industry have been and are working actively with regulators and producers to broaden the availability of coverage in such difficult lines as day care and liquor liability. Provided that regulators and others understand that a market assistance plan is not a panacea, and that there are lines in which the volatility and dimensions of the underlying exposure make voluntary efforts difficult if not impossible to undertake, the industry is ready to continue its work with individual regulators, under their leadership, to maximize the opportunities to write difficult lines in the private market.

An additional virtue of voluntary efforts is that they can rather quickly document the extent and characteristics of the problem, so that further steps, if any are needed, can be considered in the light of documented facts. In this connection the industry supports the establishment in states of telephone "hot lines" by the commissioner or

an industry group so that information as to insurance needs and available sources of insurance can be exchanged efficiently.

Voluntary plans also enable insurers to review the loss control procedures of difficult-to-insure commercial buyers and make helpful suggestions. By minimizing hazards through a loss control plan, the buyer may be able to provide a potential insurer with the assurance necessary to provide desired coverage.

3. Insurance Availability Clearinghouse

To help regulators identify admitted and surplus lines carriers that may currently be writing lines in which capacity is short, the industry proposes that a clearinghouse be established. This clearinghouse would help identify and define availability problems in the several states, provide information about markets for difficult lines and recommend regulatory and/or legislative changes that might make insurance more available. To avoid anti-trust problems, insurance regulators must play an active role in sponsoring the clearinghouse.

4. New Commercial General Liability Policy

With the uncertainties involved in trying to anticipate future losses accurately in an ever-changing legal environment, actuarial pricing has become all but impossible for some risks. Expansive interpretations affecting any area of tort liability are likely to find application in other areas as well, making even the so-called profitable risks of a few years ago potentially uninsurable.

The Insurance Services Office has recently introduced a new Commercial General Liability Policy (CGL), including a claims made form. By itself, the CGL will not and cannot solve all of the current

insurance availability or affordability problems, but its approval and use by the industry would be a positive step in restoring a degree of underwriting confidence in the general liability marketplace. Predictability is an essential ingredient in the insurance business, and without predictability some risks will no longer be assumed. The new CGL policy, with policy aggregate limits, encourages both the insurer and the insured to evaluate the risk objectively. The parties can then determine adequate limits and a definite coverage amount. Moveover, the introduction of a claims made version of the CGL allows for precision in determining the coverage period, avoids the stacking of limits and policies that now occurs and avoids costly litigation over policy application. Finally, the provision for "tail coverage" at the termination of a claims-made policy allows the insurer and policy holder to treat coverage for "Incurred But Not Reported" (IBNR) losses and its price separately, providing it only when it is needed rather than in every policy, defining the insurer's financial commitment, and pricing the coverage based on a reasonable loss expectation.

5. New Capacity

Many insurance companies are adding capital, both to assure that present business is adequately funded and to enable the writing of new business. This, coupled with adequate pricing, will do much to overcome availability problems. The industry recognizes, however, that there are limits on the amount of new capital that can be generated from insurance sources, at least until there is a thorough-going reform of the liability system. The industry, therefore, supports efforts by businesses and others to add capacity to the marketplace

through appropriate individual and group self insurance, provided that in the case of groups, they are subject to adequate regulatory supervision and result in no unfair advantages over commercial insurance.

There are, in addition, exposures that are simply too difficult for the private market to write under current rules because of the impossibility of measuring or even defining the exposure represented by businesses. Risks posed by toxic substances, such as asbestos and chemical wastes, are generally viewed by insurers as falling into that category. Unless such exposures can be clearly defined and limited by reform of the liability system, it may be that risks such as those posed by toxic waste facilities will have to be funded, in whole or in part, by public funds. Otherwise, an unacceptable choice must be made between requiring businesses to bear financially unacceptable risks themselves and imposing an involuntary and potentially catastrophic burden on the insurance industry. Clean-up costs for known toxic waste facilities have been estimated at $22 billion to $100 billion by federal government sources. Imposing even a substantial fraction of these costs on the insurance industry under the Jackson Township theory would leave little if any capacity left for all other risks consumers and businesses expect the industry to assume.

6. General Tort Reform

The trades have agreed on three general reforms that will improve the availability and affordability of insurance. These merit full and serious consideration by the legislatures in the several states. Detailed proposals will be available in January, 1986.

(a) Several Liability -- Present law in most states permits the recovery of damages from any one of a group of

defendants. Increasingly, the doctrine of joint and several liability is being abused as plaintiffs' attorneys pursue defendants with the deepest pockets for all or a disproportionate share of plaintiffs' damages, even though a defendant may have been only marginally responsible for the injury. The abuse is most manifest in cases involving municipalities where cities and towns that are only slightly responsible for the plaintiff's injury end up paying all or most of the award. The adoption of several liability would assign a defendant its share of the responsibility and no more, and the relative definition would help underwriters in assessing risks and offering insurance coverage to commercial and municipal entities.

(b) Punitive Damages -- In theory, punitive damages punish defendants who are guilty of malicious behavior and deter others from similar behavior. In fact, punitive damages are a bargaining chip in litigation and drive up the overall amount of settlements and awards. Moreover, the standards for determining when punitive damages should be awarded have eroded in recent years. The industry is in favor of the abolition of punitive damages on the ground that they are essentially criminal in nature and have no place in a civil liability system. At a minimum, the law of punitive damages should be amended so that such damages may only be awarded for truly malicious behavior.

Consideration of punitive damages should be separated in the litigation process from the determination of liability and compensatory damages, and multiple awards of punitive damages against a single defendant for the same conduct should be eliminated.

(c) State of the Art Reforms -- Especially in professional liability, municipal liability and product liability, courts have tended in recent years to permit the imposing of liability based on standards that developed after the activity in question took place. The industry is in favor of legislation that will assure that products manufacturers and professionals are judged by standards prevailing at the time. This would not only tie the tort law more firmly to commonly understood notions of responsibility, it would also enable underwriters to predict risks more precisely. Insurance buyers would have a greater incentive to conform their activities to current standards.

In addition to the three reforms already agreed upon, the trades have prepared an agenda of additional topics that will be examined in the near future in an attempt to arrive at additional agreed reforms. These are:

Repeal of the collateral source rule. This rule prohibits the introduction of evidence of payments to

or on behalf of the plaintiff from sources other than the defendant.

Ceilings on non-economic damages. Such damages are beyond a plaintiff's "out of pocket" damages, such as lost wages and medical expenses and include damages for "pain and suffering".

Retroactivity (an exploration of ways to restrict substantive changes in exposures to a prospective basis).

Dispute resolution (an examination of procedures which add delay and cost to the litigation process (e.g., discovery) or which may save time and costs (e.g. court-annexed arbitration; mini-trials).

Periodic payment of damages (ways to extend the use of structured settlements and awards).

The trades view the above as a "starter agenda" to be added to as the review process continues. In addition to the specific agenda items enumerated above and others that may be added, the trades will be exploring ways to document and measure the impact of an expanding liability system on the private insurance market and commercial activity in the United States.

7. Reforms Targeted to the Needs of Specific Buyer Groups

The trades are actively examining each area in which buyers have had difficulty in purchasing adequate coverage to determine whether there are specific legislative, regulatory or private sector proposals -- beyond the general reforms enumerated

above -- that might be advanced. For example, a package of proposals relating to dram shop liability might include a state-sponsored training program for liquor licensees; limiting liability to situations where liquor has been served to a visibly intoxicated person or a minor; and application of the statutory cause of action only where a vehicular accident occurred. With respect to units of government, a package might include partial or total immunity for defined governmental activities and a reasonable cap on awards. For asbestos removal contractors, it may be possible to tie liability explicitly to a failure to comply with state standards adopted after extensive technical and political consultations.

ILL-ADVISED CONSTRAINTS ON THE INSURANCE MARKET

The insurance industry needs a period of time to re-establish reasonable profitability. This in turn will permit the generation of new capacity to handle increasing exposures. The return to profitability and the attraction of new capital have already begun, but as the figures cited earlier in this paper attest, the process has a way to go before the industry can compete effectively with other users of capital.

This healing process could be undercut or even stopped by ill-considered actions by regulators or legislators. There are four

such ill-advised actions that, if taken, would significantly impair the ability of the industry to fund the liability system in the future. The common denominator of such measures is that they force a largely market-oriented, competitive industry to write risks that would not necessarily be written voluntarily, usually at inadequate prices. The four such actions are:

1. Financial Responsibility Provisions -- Such laws or regulations require a class or classes of buyers to show that they are financially able to meet tort judgments by the purchase of insurance or (in some instances) self insurance arrangements. While aimed at buyers, such provisions place great pressure on legislators and regulators to require the writing of insurance, whether through residual market
mechanisms or otherwise. Where the underlying exposures are large and unpredictable, such as in the environmental area, financial responsibility requirements place a severe burden on buyers that cannot be legitimately met by insurers.

2. Involuntary Market Mechanisms -- These entities, which typically require all or a portion of the admitted property-casualty insurance industry in a state to absorb deficits of the pooling mechanism, tend to become inadequately funded, "take all comers" residual markets. As such, they mask underlying liability system problems by passing the costs of a malfunctioning liability system on to insurance buyers. They have also, in the medical malpractice area, generated large deficits that must, for the most part, be borne by the insurance industry. Thus, involuntary mechanisms

could, if used extensively, add significantly to the liabilities of the industry at a time when financial results are inadequate.

3. Administered Pricing -- There has been a trend in recent years towards allowing individual companies to set prices without regulatory approval. This trend has been especially marked in commercial lines. Competitive rating laws universally allow some discretion in the insurance commissioner to regulate prices in an uncompetitive market. A return to general prior approval laws would re-establish a bureaucratic system that is slow and cumbersome and which often imposes inadequate rates. A more open system permits insurers to make quicker pricing decisions as market conditions evolve and yet contains safeguards when competition is not adequate to restrain price increases.

4. Onerous Restrictions on Cancellation and Non-Renewal -- The industry acknowledges that some constraints on freedom of contract may be needed under current conditions, but a regulation (as adopted in one state) that in effect makes the insurance commissioner the decision-maker on all renewals, cancellations and changes in terms in the state removes all underwriting discretion and adjustment from insurers. Such a regulation is likely to discourage additional insurers from becoming involved in the state and to make currently admitted insurers reluctant to write new business.

CONCLUSION

Historically, the United States has relied primarily on the private insurance industry to assume and spread risks generated by the liability system. There has been a consensus that a free market system provides the most efficient way to identify, quantify and distribute such risks.

Implicit in this consensus, however, has been the assumption that the insurance mechanism can handle an expanding liability system, at least within broad limits. Due to the escalating and unpredictable expansion of the liability system in recent years, this assumption is no longer automatically true, and the consequence is the availability problems of 1985. Therefore, as a matter of public policy, the choice is between doing nothing to constrain the liability system (in which case the insurance industry will continue to struggle in attempting to accommodate the expanding system) and working towards a balanced, more predictable system (in which case the insurance industry will be able to operate much more effectively in making coverages available at reasonable prices).

There are a number of early signs that for many affected buyer groups, the availability crisis is beginning to ease. Voluntary programs or mechanisms are in place or being planned in many states. Underwriters are beginning to look for market niches and opportunities in these areas. Additional capital is beginning to flow back into the reinsurance markets.

All of this is evidence of a healthy recovery by the insurance industry, even in the face of difficult liability system

conditions. For the reasons noted above, the recovery will not be total or permanent unless and until substantive reform is achieved, but these developments point the way to a more liveable situation while reform efforts proceed. The industry is committed to helping in this process by working with commissioners and others to make coverage as available as possible.

BEFORE THE COMMITTEE ON COMMERCE,

TRANSPORTATION AND TOURISM

CONCERNING

S.2129, THE RISK RETENTION ACT AMENDMENTS OF 1986

MARCH 20, 1986

The American Insurance Association and the Alliance of American Insurers (Associations) are trade associations which represents approximately 350 property and casualty insurance companies. The member companies of the Associations provide the majority of the liability insurance coverage written throughout the United States. We have been asked to present testimony associated with this Committee's consideration of S.2129, the Risk Retention Act Amendments of 1986. As stated by Chairman Danforth, "this legislation would provide an alternative to the commercial insurance market." Our Associations have testified to the Committee in previous hearings that our members cannot meet the needs for liability coverage in certain select lines of business and can appreciate the pressures that exists for the passage of this bill. We are grateful for the Committee's fair consideration of this legislation and thank you for giving us the opportunity to testify today.

Industry's Concerns Over the Scope of S.2129

In its current form S. 2129 is too broad. It expands the Risk Retention Act to almost all commercial lines of business including not only those where policies are currently unavailable but extending to lines of business where primary and surplus insurers are already providing a market.

Our critics will assert that we are seeking to limit competition. To this we respond that we harbor no concerns about new companies coming into our already intensely competitive industry. We do, however, have serious concerns about companies entering the insurance marketplace which are not subject to the same stringent regulations that are designed to protect the consuming public as are we. The practical effect of the legislation is that these companies will be operating at a competitive operating advantage while their customers are

deprived of the protections that state regulation currently affords consumers against unfair trade practices or potential insurer insolvency. These protection are for the benefits of the insured but also benefit injured persons whose injuries require compensation.

The Committee should remain mindful that the two major components of regulation are to provide protection to consumers against unfair practices and rates while at the same time ensuring that the company with which a consumer is doing business is financially solvent and capable of paying out any future claims. While always exercising these responsibilities, state regulators in recent years have taken a more active stand in promoting these two objectives. There have, indeed, been times when some in our industry have differed with the Insurance Commissioners yet few can argue with the results. Adequately applied solvency standards and an insurer contributed guarantee fund have left none of our customers unprotected nor required the expenditure of taxpayers' money. Yet, while the Associations would not oppose Congressional efforts to expand the Risk Retention Act to allow for the writing of lines where insurance is not available, we question the wisdom of legislation which permits the abrogation of state laws designed for consumer protection where insurance is already being provided. The risks of this approach are great and far outweigh the benefits that are being sought.

We would therefore ask that Congress amend the legislation to mandate that a company established under this Act can only do business where it has first demonstrated that the coverage that it seeks to provide cannot be obtained by other insurers that are already operating within that state's borders.

These companies should at minimum be also required to meet the financial operating standards that currently govern carriers in their states. Among other things this would include meeting the minimum capital and surplus requirements that exist under the State's laws or regulations. The adoption of this provision will help protect consumers from insurer insolvency, unfair pricing, rate discrimination and misleading contract forms that are likely to exist in an unprotected marketplace.

The Associations recognize the compelling need to go forward for several of the most distressed lines of business. For that reason, in critical lines where we are currently not providing coverage, we would recommend that companies established under this legislation be exempt from the demonstrated needs test. This would include nurse-midwives, asbestos removal, environmental cleanup and environmental liability.

We also believe that consumers would be better protected were they to be made aware of the fact that insurance companies established under this Act are not subject to the same standards for solvency as are admitted carriers. This information is vital in order to make an informed choice and must be considered a salient factor for any individual or company that seeks to transfer its liability risks to its insurer.

The Associations have worked closely with this Committee on other important legislative matters and indeed cooperated fully with its efforts in the passage of S.69, the 1981 Risk Retention Act. We intend to continue our pattern of constructive dialogue and feel that the testimony

which we offer today fosters that purpose. Our industry has a clear interest in making certain this legislation works to accomplish the dual goals of the regulated marketplace. Unlike most other products sold on the market, a consumer does not derive pleasure from our product itself, but from the peace of mind that an insurance contract brings. To the extent that lax regulation for companies established under the Risk Retention Act undermines confidence in our product, the purchaser of that contract not only suffers but so do all others who pay for our product as well.

Were the Committee to adopt our recommendations, several of our member companies have indicated that they will support the legislation. Yet it is important for the Committee to recognize that this does not necessarily mean they feel that the problems facing the business community because of liability exposure will go away. Assuming proper management, those companies which choose to have their risks insured by a company that is established under the expanded Act will still find that their liability exposure remains subject to the uncertainty of the evolving civil justice system. Their experience will probably reflect ours, as did the Medical Mutual Malpractice Companies established a decade ago. Speaking before this Committee two weeks ago, Dr. James Todd of the American Medical Association told you that the Medical Mutuals did indeed enjoy significant apparent profits during their first years of operations. The results changed dramatically once claims started to be filed and the rate increases of Medical Mutuals like ours have gone up dramatically to reflect trends in the civil justice reform that have expanded physician's exposure. We therefore hope the adoption of this legislation will not divert efforts taking place on the state level for comprehensive reform of the civil justice system.

In concluding, the Associations believe that the imposition of minimum consumer protection safeguards are clearly in the public interest and could very well spare this Committee from complaints which might arise two or three years from now from consumers who entrust their financial future with an uregulated carrier.

We would again thank you for providing us with the opportunity to testify and want to assure you that we intend to work closely with you in improving this legislation as the process goes ahead.

BEFORE THE SENATE COMMITTEE ON COMMERCE,

SCIENCE AND TRANSPORTATION

CONCERNING

S.1999, THE PRODUCT LIABILITY VOLUNTARY CLAIMS

AND UNIFORM STANDARDS ACT

MARCH 24, 1986

The American Insurance Association (AIA) is a trade association which represents 177 property and casualty insurance companies. The member companies of the Association provide the majority of the liability insurance coverage written throughout the United States. We have been asked to present testimony associated with the scope of the availability and affordability of product liability insurance as well as on S.1999, the Uniform Product Liability legislation introduced at the end of the last session by Senator Danforth. We applaud Chairman Danforth for his recognition of the product liability problem and believe that the introduction of S.1999 is a positive step in our search for a solution to this critical problem.

General liability insurance rates have increased sharply during the last two years. The principal reason for increased rates is the dramatic losses that we have recently suffered in this line of business. Testimony provided to this Committee by various product manufacturers and sellers has demonstrated that the number of product liability claims and the number of awards has gone up dramatically in the last ten years.

In most instances, insurance companies pay for these huge awards. It is therefore not surprising that insurance rates increases for product liability insurance has gone up dramatically as the risk associated with the sale or distribution of a product has been heightened by a tort system gone astray.

UNDERLYING CAUSES

Traditionally, tort law punishes those who have done wrong by making them compensate those whom have been injured as a result of their actions. Increasingly, however, tort law has evolved so that it punishes those who have

done no wrong but instead have the ability to compensate the unfortunate. The trend is particulary pronounced in the expansion of strict liability doctrines in the areas of design defect and failure to warn. Strict liability though more generous to plaintiff than common law was nevertheless still a fault based system. Yet Recent court decisions have created new and unpredictable liabilities for property casualty insrurers. As stated in the Villanova Law Review:

> In two recent toxic tort cases, the highest courts of California and New York have held that liability for injuries allegedly caused by DES can be imposed upon defendant manufactures without proof that those defendants made DES which caused the plaintiff's injury. In Sindell v. Abbot Laboratories (1980), the California Supreme Court accomplished this result by fashioning a "market share" theory of liability. Under this theory each defendant was liable for the proportion of the judgment represented by its share of the DES market unless the defendant could demonstrate that it could not have made the product which injured the plaintiff. Susequently, in Bicher v. Eli Lilly & Co. (1982), the New York Court of Appeals affirmed a jury verdict against a manufacturers of DES which is based upon the plaintiff's theory that Lilly, in concert with other DES manufacturers, had wrongfully marketed this drug without proper testing. Under this "concert of action" theory, the court in Bichler found the defendant liable for the plaintiff's injuries even though the plaintiff had failed to prove that Lilly--the only defendant named in the suit--was the manufacturer of the DES that the plaintiff's mother had ingested.[1]

In both Sindell and Bichler, the rationale underlying the courts' decisions was the same. In both cases, the court was confronted with an innocent victim unable to prove which manufacturer harmed her because of the long latency of the injury coupled with the similarity among the products of the different manufacturers. Faced with a choice between not compensating the

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[1]Villanova Law Review, Volume 28, No. 6, September, 1983, p. 1102-1104

victim and holding liable a company which may not have caused the harm, each court chose a theory which would permit compensation of the victim.

Similarly, court decisions have weakened defenses based upon the state of the art and technological or economic feasibility. In Beshada v. Johns Manville Products Corp.(1982), a strict liability case in which the plaintiff asserted that an asbestos manufacturer was responsible for damages arising out of the use of asbestos the New Jersey Supreme Court ruled that the defendants could not introduce state of the art evidence supporting their claim that the health hazards arising from exposure to insulation products containing asbestos was scientifically undiscoverable at the time the plaintiff suffered the injury. The court reasoned that if the cost of the injuries is imposed upon manufacturers then the manufacturers can spread the loss by purchasing insurance and incorporating the costs of the insurance in the product's price. Yet, the Beshada defendants correctly reasoned that the because unknown hazards cannot be predicted, the costs of these hazards will not be reflected in the price of the products, but instead will be borne by the public at large through general undifferentiated price increases. The court, more interested in compensating the asbestosis victims, conceded that although there was "some truth" to the defendants arguments," it is not a bad result." Uncertainty exists as the court abandoned precedent to advance a compensation system for an entire class of plaintiffs. Needless to say, product suppliers and their insurers remain strongly concerned as to whether or not legal environment will continue to evolve to their detriment.

These fears have been bourne out as other courts have expanded upon this New Jersey decision. In Elmore v. Owens Illinois (1984), the Missouri Supreme

Court expanded the decision by denying the defendant the use of the state of the art defense in a strict liability case involving the design of a paint which contained an additive that was found to be harmful 20 years after the product was first marketed.

Those who support these recent court decisions usually focus on fairness to the victim. In a case involving an unknowable risk, they conclude that, as between two innocent parties--the manufacturer and the consumer--it is fair to shift the financial burden to the party who caused the injury.

Yet they neglect the fact that this imposes an impossible task on insurers and imposes an unfair burden upon a product manufacturers and to society as a whole. Manufacturers should not be forced into bankruptcy merely because they had the misfortune of producing dangerous products at a time when those dangers were scientifically unknowable. Society suffers as manufacturers are reluctant to introduce or maintain the sale of certain high risk but very beneficial products to those who need them.

American pharmaceutical and chemical manufacturing companies face increased exposure to liability at every turn resulting in higher liability insurance rates and significantly reducing their ability to meet the challenges from international marketplace competitors who are not so burdened by court decisions in their countries of origin. This is true even where they have done everything possible to avoid injury and have met or exceeded all legal and regulatory requirements. While 13 firms manufactured football helmets just a few years ago now there are only two as their competitors were forced to discount operations because of increased liability exposure. A nationwide shortage of the DPT vaccine against diphteria and whooping cough

exists because of the high liability exposure associated with the sale of this very beneficial and highly regulated product.

The cases are not always as esoteric as those which were cited earlier. In Faust v. Swift and Company (1985), a Pennsylvania court recently held that a peanut butter manufacturers may be held liable for the brain injuries sufffered by a 16-month-old infant as a result of choking on Peter Pan Creamy Butter Spread. The court totally dismissed the assertion of the manufacturer that the infant's mother knew or should have known the potential dangers associated with feeding a peanut butter sandwich to her son.

In another Pennsylvania case, a man won a $1.2 million award, $550,000 in damages from Sears after suffering from a heart attack while trying to start his mower. The man who had a history of heart disease charged that the pull start on this Sears lawn mover required to much exertion. Yet, had it been easier a child might have started the mower and exposed Sears to similar damages.

Under this environment it is not surprising the insurers are having an almost impossible time in evaluating the risks associated with the sale or manufacture of a product. Courts have not only totally rewritten retroactively the basis of tort law but have changed it to apply most harshly in instances where businesses or municipalities with "deep pockets" are the defendants. A study by the Institute for Civil Justice of 9000 jury trials in the Chicago area shows that jurors return one third more damages against corporate defendants than against individuals.

Clearly the problems brought about because of the dramatic changes in our tort laws have not been limited to product liability cases. Municipalities,

day care centers, restaurateurs, truck fleet operators and corporate directors and officers are a few among a long list of entities that have found their exposure to liability increased in recent years as courts expand the theory of joint and several as well as strict liability. The American Insurance Association is aggressively working in the state legislatures throughout the nation for state law reforms that will more narrowly reduce liability to instances where the party acted with fault. Because 70 percent of all products manufactured are sold in interstate commerce a state oriented solution for product liability risks might not be necessarily effective for solving the liability problems associated with the production and distribution of manufactured products. Individuals will inevitably forum shop and seek to bring their cases to courts in states where they are most likely to prevail.

AIA'S CONCERNS ABOUT S.1999

AIA remains supportive of Title III of S.1999. The legislation reaffirms the traditional principles of tort law and imposes liability upon a manufacturer: (1) where his product was the proximate cause of the harm suffered by the claimant; and (2) where he was negligent in either the construction or design of the product or in providing warning or instructions about a danger connected with the product. The enactment of Title III would impart greater certainty to the tort system, making it possible for risk managers and insurers to predict the potential liability associated with the production or distribution of products.

While we are not opposed to the development of an alternative compensation system such as that proposed in Title II, we nevertheless have concerns over its current formulation. Specifically, Section 203(d), which permits an

individual to recover for damages in instances where it is impossible to identify the manufacturer of an indistinguishable product, should be amended to provide that liability would only attach to activities that are representative of market share. Should joint and several liability exist, it would be almost impossible for insurance companies to assess the degree of potential liability and a number of products would remain uninsurable.

In addition, Section 205(b) adopts the California Supreme Court decision in Barker v. Lull Engineering which places the burden of proving that a product is not "unreasonably dangerous" on the manufacturer, and in addition, imputes knowledge to the manufacturer. It establishes a risk utility test under which the manufacturer can overcome the presumption of liability only by demonstrating that the product's utility so outweighs the risk of harm that a person knowing of such a risk is justified in placing the product into commerce.

The problems of insuring an action in which the burden of proof lies with the defendant becomes even more difficult by the narrow discovery rules under Title II. The knowledge of whether or not the claimant used the product in a negligent manner rests almost entirely with him and under Title II the defendant would has an almost impossible time in ascertaining the true nature of the incident that gave rise to claim.

As an alternative, we recommend that Section 205(b) establish more objective guidelines governing the respective responsibilities of both the product producer and the product user. A claimant should be required to demonstrate by a preponderance of the evidence that the product in normal use was the proximate cause of the harm suffered and that the product was

unreasonably dangerous. For the claimant to prevail he should have to demonstrate that the product: (1) differed in material respect from the manufacturer's own specifications in a manner making the product unsafe for the use intended by the manufacturer; or (2) the design of the product is unsafe for use in the manner intended by the manufacturer; or (3) that the warning of the risks associated with the product's use in its intended manner was inadequate to enable the claimant to avoid those risks or to make an informed decision about assuming them. On balance, we believe that the language contained in the first draft better accommodates our views.

Our third concern lies with Section 205(d) which governs cases where a claimant has suffered a toxic harm that manifests itself only after many years of exposure. It creates a presumption of causation if a plaintiff was exposed to a chemical or toxic agent, without either defining what constitutes exposure or whether or not the chemical product was unreasonably dangerous. The burden becomes all that more greater for the defendant as the product manufacturer is denied opportunities to refute the allegations asserted by the claimant.

While subsections 205(d)(1)(B) and 205(d)(2) seek to provide clarifications governing the attachment of liability, they are inadequate in that regard. The terms of both subsections are loosely defined and the 30 percent elevation threshold established in (d)(2) fails to define the control group or provide assurances that the tests conducted are properly performed. Furthermore, the language appears to preclude consideration of other factors that might have more greatly contributed to the harm suffered. This would include in part other toxic substances, dietary habits and the genetic

predisposition of the claimant. It is indeed possible that the implementation of this section would only result in the invitation of claims in which a claimant would enjoy an almost absolute right of recovery. Clearly, the ability to insure a chemical company under these circumstances would be questionable at best and would almost certainly result in higher rates for our customers than those under the present tort system.

Our last comments are addressed to the retroactive application of Titles II and III. Our industry has learned that retroactive legal changes are a major impediment to insurance predictability. As the bill stands now with the current formulation of Title II it will mean that insurers will have their liability exposure increased for areas in which no insurance premiums have either been or will be collected. Should a large number of new claims be filed under Title II the results might prove to be disappointing and perhaps exacerbate the trend towards higher potential liability associated with the production or distribution of manufactured products.

Other provisions of this legislation such as the coordination between product liability claims and workers compensation benefits are essentially procedural and don't pose retroactivity problems. While this may be may prove to be more expensive than the current system it nevertheless offers the possibility of being more predictable and possibly less expensive in the long run.

The American Insurance Association is mindful of the Committee's willingness consider the views of the many competing interests that are impacted by this legislation. We stand prepared to work with the Committee in

efforts to work ahead in the months ahead with a meaningful solution to the product liability problem.

Respectfully submitted,

Peter A. Lefkin
Counsel
American Insurance Association

INSURER PROFITABILITY—THE FACTS

A commentary on the
financial condition of the property/casualty
insurance industry

p. 50

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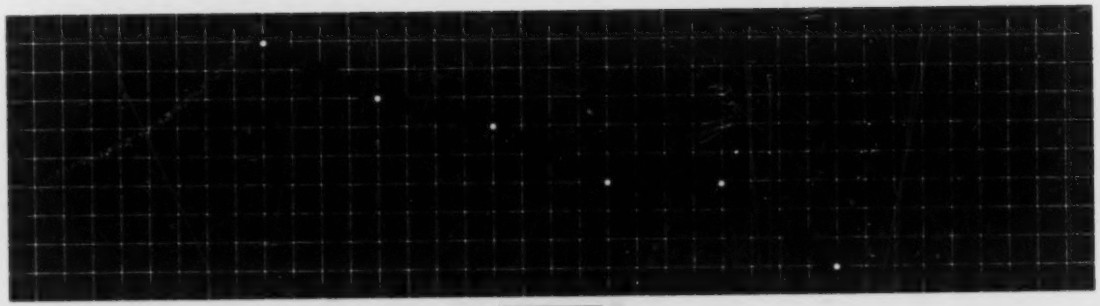

Insurance Services Office, Inc.
February 1986

PURPOSE

Given the current condition of the property/casualty insurance marketplace—with affordability and availability problems affecting many commercial insurance consumers—several critics have charged that the current large liability premium increases are unnecessary, that the industry's financial condition is improperly stated, and that its accounting procedures are misleading. In this analysis, Insurance Services Office, Inc. provides a fact-based review of the property/casualty insurance industry by (1) presenting a broad perspective of the industry's current financial condition, and (2) responding to factual errors and irrelevant data intended to substantiate the critics' charges, as well as providing a meaningful context for the numbers.

NOTE: Actual year-end 1985 results for the property/casualty insurance industry will not be compiled until late March 1986. Industrywide year-end figures cited by various analysts and critics in January 1986 were estimated results based largely on financial data through the first nine months. In this analysis, ISO references the financial statistics most often cited by critics—those estimates published by A.M. Best Company. This report is being issued prior to the release of year-end 1985 results in order to promptly provide comprehensive information.

The source of all historical financial data through 1984 is A.M. Best Company, with exceptions as noted. Nine-month 1985 financial data come from the A.M. Best Company or ISO compilations.

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CHARGES
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- Insurers publicize operating income, rather than net after-tax income, in order to show losses./**21**
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ACCUSATION: Price increases are excessive. Losses are not the problem.

CHARGES
- The industry needed to increase premiums only 12-15% in 1985 to achieve a 13-15% return in 1986. Given the estimated 20% premium increase in 1985, no additional price increases are needed in 1986./**25**
- Premium increases are so dramatic today solely because of prior inadequate prices. Losses are not the problem./**25**
- 1985's 71% increase in general liability premium was excessive. If insurers had not slashed liability rates a few years ago, they would have earned handsome profits./**28**
- Since, for medical malpractice, paid losses are less than investment income, this line can be treated on a "pay as you go" basis./**29**

ACCUSATION: Insurers are making substantial profits and paying no taxes. There's nothing fundamentally wrong with industry profitability. This is just a typical cyclical downturn.

CHARGES
- Property/casualty insurer stock prices rose by 50% in 1985, hardly indicative of a troubled industry./**31**
- The industry made $75 billion over the last 10 years and paid no taxes./**31**
- This is a typical cycle for the industry, and it will recover quickly./**33**

ACCUSATION: Insurance is too expensive.

CHARGES
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7

EXECUTIVE SUMMARY

A financially sound U.S. property/casualty insurance industry provides a vital service in the form of needed security to individuals and corporations. The cost of insurance affects almost every aspect of American life. Consequently, the economic integrity of this industry, as well as the availability and affordability of insurance, are critical to society.

In the past year, differences have emerged between the property/casualty insurance industry and its critics over the true financial condition of the industry and the need for large commercial liability premium increases. This has occurred despite the fact that quarterly and annual reports of the industry's financial results, as well as several special studies, have documented the weakened state of the industry and its current low profitability.

Critics have taken the industry's published financial information and distorted it to assert that, rather than being in financial peril, property/casualty insurers are actually engaged in price gouging and are hiding current profits. These charges are misleading, unsubstantiated and false.

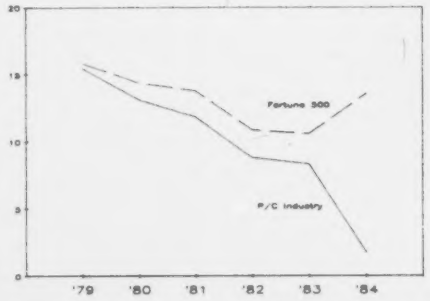
This analysis reviews the current financial state of the industry and refutes, on a point-by-point basis, the critics' charges.

All facts point to the inevitable conclusion that 1984 was the worst year to date for the property/casualty insurance industry. The weakened condition of the industry is highlighted by:

- a return on net worth of less than 2% and an operating loss of nearly $4 billion, both record low levels;
- a record number of insurer insolvencies;
- a record number of insurers placed on a "watch list," based on tests of financial strength developed by the National Association of Insurance Commissioners; and
- a wholesale downgrading of insurer ratings by A.M. Best Company.

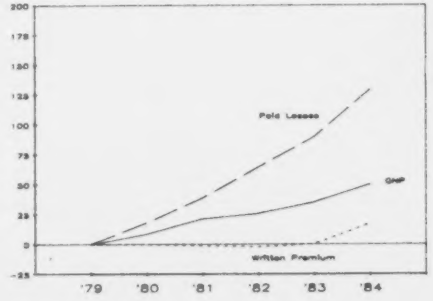
During the 1980's, the return on net worth for the property/casualty industry moved increasingly below the average rate for the Fortune 500 companies. (See chart A.) And results for the first nine months of 1985 indicate no major improvement in profitability. The annualized return on net worth was 4%, and operating losses as of nine months were at record levels. Rather than producing large profits for insurers, the 1985 premium increases have slowed the dramatic downslide and possibly signalled the beginning of the long road back to adequate levels of profitability. The number of insurer insolvencies in 1985 has already matched the all-time record, set in 1975, with the books for 1985 insolvencies not yet closed.

Critics have made charges about the industry's financial condition that fall under four



A

Return on Net Worth: Property/ Casualty Industry vs. The Fortune 500 (%)



B

Loss Growth and Premium Growth vs. GNP (%): Commercial Liability

broad accusations. The following paragraphs summarize these charges and ISO's responses.

- **The industry's accounting procedures regularly misrepresent its true financial condition. The profitability "crisis" is manufactured.**

  This analysis notes that the industry's accounting procedures are in accordance with those promulgated by the Financial Accounting Standards Board (FASB) and state regulatory authorities. The analysis refutes the charges that the industry's lack of profitability is due to creative accounting, that loss reserves are overstated whenever the industry chooses to create a crisis, and that policyholder dividends and capital gains are improperly treated.

- **Price increases are excessive. Losses are not the problem.**

  This analysis shows that the recent, substantial commercial liability price increases are necessary. The explosive growth in claim payments, in combination with depressed premiums, continues to create an urgent need for large premium increases in the commercial lines. These premium increases will not recoup lost profits; rather, they have begun the process of bringing current premiums in line with current losses. Losses *are* a serious problem, since loss growth substantially outpaced growth in GNP. **(See chart B.)**

  The underlying causes of loss growth are not discussed in detail in this strictly financial analysis. But it is clear that the property/casualty insurance marketplace's difficulties—low insurer profitability and the impact of premium increases on policyholders—have now led to a significant public debate regarding the nature of liability in our society.

- **Insurers are making substantial profits and paying no taxes. There's nothing fundamentally wrong with industry profitability. This is just a typical cyclical downturn.**

  This analysis demonstrates that long-term profitability has been poor, with insurers' return on net worth below the average of the Fortune 500 companies in eight of the last 10 years. The last two years have been particularly poor, even for a low point in the cycle. This is not a typical cycle. It is both longer in duration and deeper in magnitude than any previous cycle in the property/casualty insurance industry's history. With regard to taxes, the analysis indicates that the industry is in compliance with federal law.

- **Insurance is too expensive.**

  This charge is both misleading and emotionally charged. First, the critics include life, accident and health insurance premiums with those for property/casualty insurance, thereby increasing the figures in their charges. Second, losses have increased dramatically, and the premiums to pay for them must rise as well.

Conclusion

The property/casualty insurance industry's rate of return must improve, and insurers must achieve profits consistent with the risks they assume. Higher returns are needed for the industry to retain its capital base and attract new funds. Such stability and expansion are crucial if insurers are to have the capacity to provide needed insurance in the coming years.

11

OVERVIEW OF THE FINANCIAL CONDITION OF THE PROPERTY/CASUALTY INSURANCE INDUSTRY

In the past year, differences have emerged between the property/casualty insurance industry and its critics over the true financial condition of the industry. The insurance industry claims that it is experiencing unprecedented losses, while its critics claim that the industry is really profitable. This section will provide the facts.

A critical measure of financial results is the return on net worth, which is commonly used by investors for inter-industry performance comparisons. Responsible analysis of any industry must also look beyond that measure and evaluate the components of economic income. How does the property/casualty industry make its money? What impact do state and federal regulations have on insurance accounting procedures? What are the components of net income after taxes? Which of those components are inextricably tied to the underwriting operations of insurers? Which are subject to fortuitous events?

This section examines the elements that are critical to any analysis of insurer profitability. The following conclusions emerge:

- 1984 was the worst year to date for the property/casualty insurance industry.
- Year-end 1985 results will show no significant improvement over 1984, despite substantial premium increases.
- The companies that insure our nation's businesses have been particularly hard hit.
- Reinsurers have experienced large financial losses.
- Recent insurance industry financial results would have been worse without unprecedented realized capital gains and tax credits.
- Premiums will have to increase faster than claim costs in order to achieve positive operating income in future years.

The key support for each of these conclusions is as follows:

1984 was the worst year to date for the property/casualty insurance industry.

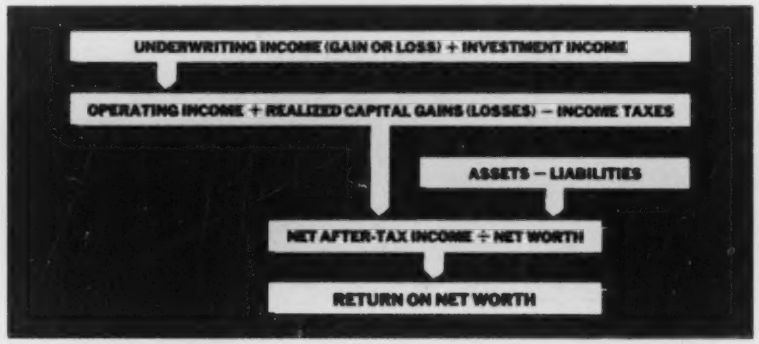
The industrywide return on net worth[1] was below 2% in 1984, with total earnings of $1.3 billion. The Fortune 500 companies' median return was 13.6% in 1984, averaged 13.2% over the last ten years, and has never fallen below 10% over that span. During the 1980's, the return on net worth for the property/casualty industry has moved increasingly below the average rate for the Fortune 500. **(See chart 1.)**

Some insurers reported returns higher than the industry average in 1984, while others had

[1] *Return on net worth is net income after taxes divided by total net worth. In this report, both income and net worth figures have been calculated to be consistent with generally accepted accounting principles (GAAP) as set forth by the Financial Accounting Standards Board (FASB). GAAP-adjusted figures for both income and net worth are larger than corresponding statutory figures, which are based on more conservative measurements. For example, in 1984, statutory surplus was $64 billion compared with GAAP-adjusted net worth of $75 billion; statutory net income was $0.8 billion compared with GAAP-adjusted net income of $1.3 billion.*

THE MAJOR COMPONENTS OF INSURER PROFITABILITY

Operating income comprises underwriting income and investment income. It is a component of net after-tax income. The other major components are realized capital gains (losses) and income taxes. An insurer's net worth consists of assets minus liabilities.


UNDERWRITING INCOME (GAIN OR LOSS) + INVESTMENT INCOME
OPERATING INCOME + REALIZED CAPITAL GAINS (LOSSES) – INCOME TAXES
ASSETS – LIABILITIES
NET AFTER-TAX INCOME ÷ NET WORTH
RETURN ON NET WORTH

lower earnings. Many companies actually lost money overall. In fact, 330 of the nation's 867 insurer groups, representing 40% of industry premiums, recorded negative returns. Eighty-four insurers lost more than one-quarter of their surplus during 1984.

The most important component of insurers' net income after taxes is operating income—the sum of underwriting income and investment income. It represents profit or loss from insurance operations. Other components of net income after taxes include realized capital gains and federal income taxes. The diagram on page 12 illustrates the relationships among the major components of insurer profitability.

Underwriting income (the difference between premiums earned and the sum of losses on claims, expenses and policyholder dividends) has actually been underwriting *loss* beginning in 1979. Each subsequent year brought ever-growing underwriting losses—reaching a staggering $21.5 billion in 1984.

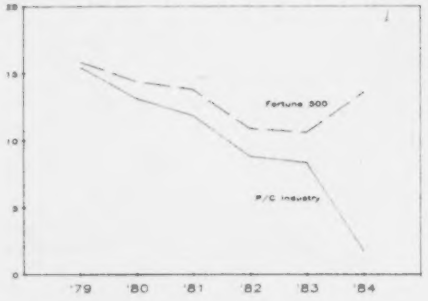
In all but two years of its history, the industry's *investment income* (the interest and dividends received on investments) was enough to offset underwriting losses. **(See chart 2.)** The first time investment income did not exceed underwriting losses was in 1975, when investment income fell short of the underwriting deficit by $300 million. In 1984, a new record was set, with underwriting losses exceeding investment income by $3.8 billion. Only unusually large realized capital gains and tax credits allowed the industry's bottom-line earnings to be positive in 1984.

Year-end 1985 results will show no significant improvement over 1984, despite substantial premium increases. Figures for the first nine months of 1985 showed slight improvement over the comparable period in 1984, but the annualized 4% return on net worth was still far from acceptable by any business standard. It is unlikely that the full-year 1985 returns on net worth will exceed 4%.

The underwriting loss for 1985 will exceed the 1984 record of $21.5 billion. During the first nine months of 1985 the industry recorded an underwriting loss of $17.8 billion, compared with a loss of $15.2 billion for the first nine months of 1984.

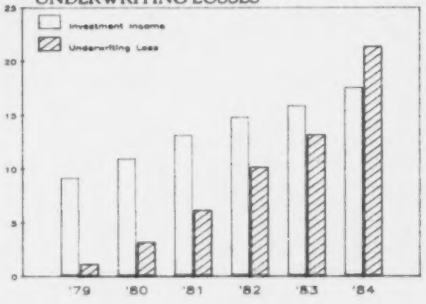
During the first nine months of 1985, investment income fell short of the underwriting loss by $3.5 billion, compared with a

1 PROPERTY/CASUALTY RETURNS HAVE PLUMMETED



Return on Net Worth: Property/Casualty Industry vs. The Fortune 500 (%) *Returns on net worth for the property/casualty industry have consistently lagged behind those for the Fortune 500 companies, plummeting 12 points below the Fortune 500 in 1984.*

2 INVESTMENT INCOME NO LONGER OFFSETS UNDERWRITING LOSSES



Investment Income vs. Underwriting Loss ($ Billions) *Investment income offset underwriting losses in every year from 1979 to 1983. In 1984, investment income fell short—creating a $4 billion operating loss. This operating loss will continue at least through 1985.*

shortfall of $2.5 billion for the first nine months of 1984. All available evidence indicates a record operating loss for 1985.

The companies that insure our nation's businesses have been particularly hard hit. The degree of deterioration in insurers' claim experience has varied greatly by type of insurance. In general, the results for commercial lines (insurance coverages purchased by businesses) have deteriorated more severely.

Since 1979, insurers that concentrated in the personal lines fared better than those that concentrated in the commercial lines. **(See chart 3.)** While personal lines insurers' profits dropped from 1979 to 1984, their decline was more moderate. The return on net worth for predominantly personal lines insurers fell from over 13% in 1979 to below 8% in 1984.

Insurers that concentrate in commercial lines have experienced a much more dramatic drop in earnings. In 1979, this group achieved a slightly higher return than personal lines insurers, posting a 15% return on net worth. The return declined during the early 1980's, reaching a *negative* 3% return on net worth in 1984.

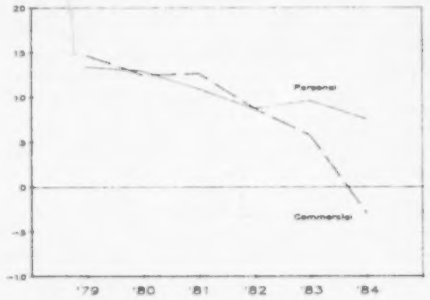
Reinsurers have experienced large financial losses. Insurance companies are in the business of assuming risk, but in many cases the potential claims are too uncertain and too large for any one company to absorb. This is particularly true for liability policies covering government entities and many large corporations, which may require coverage limits of $50 million or more. In response to these expanding liability coverage needs, reinsurers[2] (often described as companies that insure insurance companies) have grown to be an important segment of the property/casualty insurance industry and a crucial link in providing many necessary types of insurance coverages.

Reinsurers are often involved in the riskiest coverages. Financial and economic theory dictates that they should therefore be rewarded with larger expected average returns on net worth. In fact, recent returns for reinsurers have been worse than the industry average.

From 1979 through 1983, U.S. reinsurers' returns on net worth were comparable to those of the entire industry. **(See chart 4.)** In 1984, reinsurers' returns plummeted to a *negative* 10%, nearly twelve points below the industry

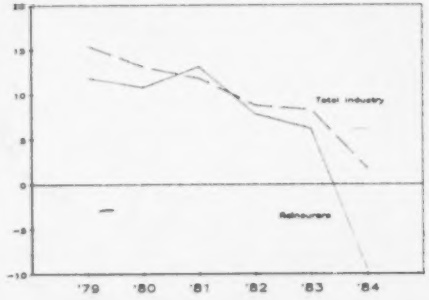
[2]*For a more thorough discussion of reinsurance, see the Appendix.*

3 COMMERCIAL INSURERS LOST MONEY IN 1984



Return on Net Worth: Personal vs. Commercial Insurers (%) *Commercial lines insurers have experienced a dramatic decline in their returns on net worth over the last four years, dropping to negative 3% in 1984. Personal lines insurers' returns also declined, but less precipitously.*

4 REINSURERS LOST MONEY IN 1984



Return on Net Worth: Reinsurers vs. Total Property/ Casualty Industry (%) *U.S. reinsurers lost money in 1984 — a factor in 1985's commercial lines marketplace.*

average. This result was a significant factor in the insurance marketplace disruptions that occurred in 1985. Many reinsurers withdrew partially or totally from writing business; others restructured coverages (adding exclusions or restrictions) and increased prices in an attempt to return to profitability.

Recent insurance industry financial results would have been worse without unprecedented realized capital gains and tax credits.

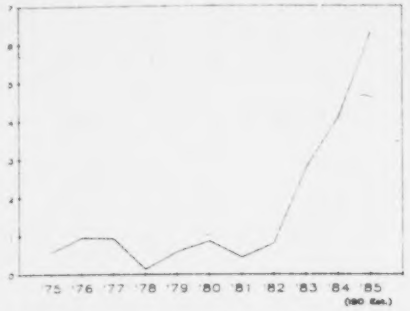
The major components of net income after taxes are operating income (the sum of underwriting income and investment income), realized capital gains and federal income taxes. Although the industry produced an operating loss of $3.8 billion in 1984, this loss was offset by other sources of income. These other sources of income are not predictable or regularly recurring and therefore cannot be depended on to provide similar amounts of additional income in future years.

A major source of non-repeatable income for many insurers during the last three years was *realized capital gains*. These gains occur when insurers sell assets that have risen in value since they were purchased. Until very recently, capital gains realized by the property/casualty industry were relatively insignificant compared to net worth. **(See chart 5.)** From 1975 to 1982, total realized capital gains never exceeded 1% of net worth. In 1983, the ratio grew to 3% and continued upward in 1984 to 4%.

Capital gains may be realized under two sets of circumstances. If the overall stock market performance is relatively flat, offering little if any appreciation in value for shareholders, large investors with a portfolio of both winners and losers may be able to sell the winners—stocks that increased in value since the time of purchase. These investors will have realized a capital gain. But by keeping the losers, they have incurred an offsetting *unrealized* capital loss, since their portfolio account now consists of stocks with depreciated value. These circumstances generally prevailed in 1984.

Under a second set of circumstances, exemplified by 1985, the stock market rises dramatically. Under those circumstances, investors may be able to realize extraordinary capital gains. But if the existing securities are sold and new ones are purchased, only additional substantial market appreciation will produce

5 REALIZED CAPITAL GAINS AT RECORD LEVELS



Realized Capital Gains (% of Net Worth) *Realized capital gains grew to unprecedented levels in 1984 and 1985.*

further large capital gains. And the effect of large realized capital gains distorts earnings over a short period of time.

Any quantitative analysis of profitability for a particular year requires an adjustment to reduce the distorting effect of abnormal events. Recording the results of a dramatic but short run stock market rise or the realization of a capital gain that actually accumulated over many years as an element of only the latest year's profit is highly misleading. The effect of abnormal realized capital gains—as well as capital losses or any catastrophes—should, for purposes of analysis, be averaged or smoothed over several years. Certainly, in assessing future years' rates of return, only a "normal" amount of realized capital gains should be assumed.

A second major source of non-repeatable income for insurers in the last few years is tax credits. Tax credits are available to those businesses that have incurred a pre-tax net loss for a given tax year and paid taxes during a prior profitable period. Tax credits may also be used by a company that is a subsidiary of an otherwise profitable parent. During the last two years, nearly $4 billion in tax credits have been utilized by the property/casualty industry. Clearly, tax credits at these levels cannot be expected to continue.

In summary, the property/casualty insurance industry benefited from nearly $5 billion of realized capital gains and tax credits in 1984. Without those extraordinary items, the industry would have incurred a large overall net loss. Over the prior twenty years, the average of total capital gains and federal income taxes was a net of only $500 million a year. Given their historically small contribution to total profit, realized capital gains and tax credits cannot be relied upon to provide a continuing and consistent bailout for operating losses. If the industry is to maintain a reasonable level of profitability for the long term, profits must come from operating income.

Premiums will have to increase faster than claim costs in order to achieve positive operating income in future years.

Positive operating income—the difference between underwriting loss (after policyholder dividends) and investment income—has been hard to achieve. Although investment income has grown steadily over the last decade to nearly $18 billion in 1984, its average annual increase since 1980 has been less than $2 billion, while underwriting losses increased at an average annual rate of over $4 billion. All available evidence indicates a record operating loss for 1985, despite substantial premium increases. If operating income is to become a source of profits, underwriting losses must be drastically reduced from the 1984 level of more than $21 billion. For this to happen, premium increases would have to continue to exceed the rate of growth in claim costs.

17

MAJOR CHARGES RAISED BY INDUSTRY CRITICS

The property/casualty insurance industry has recently been a target of criticism. Critics charge that, by manufacturing a crisis, insurers hope to lobby legislators to implement tort reform. A notion common to many of these criticisms is that the "actual" results reported by insurance companies are not actual at all, because they are based on *estimates* of loss reserves that insurers set aside to cover future loss payments. Some critics argue that the industry inflates the amount of money it reserves when it wants to show that it is unprofitable and puts less money in reserves when it chooses to show a profit. History does not support these charges. Financial analysts of the business have noted that, in times of low profitability, many insurers set aside less than they should to cover future losses on current or past policies.

The following pages contain 13 specific charges, together with the relevant facts that refute these charges, organized under four major accusations:

- The industry's accounting procedures regularly misrepresent its true financial condition. The profitability "crisis" is manufactured.
- Price increases are excessive. Losses are not the problem.
- Insurers are making substantial profits and paying no taxes. There's nothing fundamentally wrong with industry profitability. This is just a typical cyclical downturn.
- Insurance is too expensive.

ACCUSATION

The industry's accounting procedures regularly misrepresent its true financial condition. The profitability "crisis" is manufactured.

CHARGE: The industry manipulates its financial results by deliberately misstating reserves held to make future loss payments. Industrywide estimates of future loss payments are often overstated, thus producing a "crisis." During the last "crisis," the industry seriously overreserved, particularly in medical malpractice. It has again manufactured this current "crisis" in availability and affordability by overstating reserves.

THE FACTS: These charges have no basis in fact and contradict the consensus opinion of acknowledged financial analysts, who believe that current loss reserves are understated. A published ISO study concluded that year-end 1982 industrywide loss reserves were deficient by more than 10%. Subsequent ISO analyses indicate that no significant strengthening occurred in industry loss reserves through year-end 1984. Furthermore, experience has shown that industry loss reserves were seriously *understated* at the time of the last "crisis" in 1976.

It is true that loss reserves are estimates, made by insurers on a given date, of liabilities for additional loss payments that will ultimately be made for a particular set of claims. State insurance commissioners, charged with overseeing the solvency of insurers, suggest that these liabilities be reported at their full ultimate value for most lines of insurance. Reserves are particularly significant for the liability lines, for which the final payout may not be known for many years, which is why such lines are known as "long-tail" lines.

At the time of the last "crisis"—1976—the reserves set aside at year-end 1976, for all claims incurred to that date, were $47.1 billion. As of year-end 1984, $48.6 billion had been paid out on those initial pre-1977 claim reserves. And an additional $8.0 billion was still held in reserve for the same group of claims—for a total payment of $56.6 billion rather than the $47.1 billion originally expected. The nearly $10 billion difference represents an initial reserve deficiency of 20%. **(See chart 6.)**

One reason that reserves set in the past for long-tail lines such as general liability have proven to be deficient is that scientific, technological and societal changes have revealed new sources of exposure to injury and new theories of legal liability. For example, when general liability loss reserves were established 10 to 20 or more years ago, insurers could not have predicted the huge number of claims related to asbestos, Agent Orange, DES, and other alleged causes of latent injuries under policies already written. At that time, no reserves were set up for future payments of those losses. It is now clear

that the initial general liability reserves will prove to be significantly understated.

This pattern of underreserving can easily be seen in two particularly long-tailed lines, general liability and medical malpractice. In 1976, general liability claim payments already made, plus the reserves carried for future payments on policies written through that year, totaled $24.0 billion. At year-end 1984, the estimated costs for those same general liability claims had risen to $28.0 billion, of which $26.0 billion had already been paid. (See chart 7.) This means that, as of year-end 1984, the original 1976 general liability reserve was already *insufficient* by $4 billion.

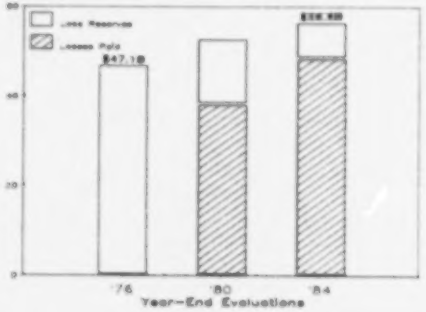
For medical malpractice, the estimate for ultimate claim payments on the policies written through 1976 initially totaled $1.9 billion. The year-end 1984 estimate for those same medical malpractice losses had risen to $2.3 billion, of which $1.9 billion had already been paid. (See chart 8.) This means that, as of year-end 1984, the original 1976 medical malpractice reserve was already *insufficient* by $400 million.

The 1976 loss reserves were not unique. More recent years show a similar pattern of final losses that are likely to exceed the initial reserves. For example, the 1979 reserve for liability lines was $65.3 billion at year-end 1979. As of year-end 1984, $53.8 billion of those reserves had been paid and $15.7 billion was still held in reserve, for a total of $69.5 billion—an initial reserve *deficiency* of more than $4 billion (6%) as of year-end 1984. (See chart 9.) Given recent historical trends, it is likely that estimated final claim payments—and, therefore, the reserve deficiencies—will grow as later evaluations are made.

CHARGE: Policyholder dividends should not be included with losses in determining underwriting results. Policyholder dividends are not a business expense, but a voluntary choice of profitable companies to distribute some of the profit to policyholders.

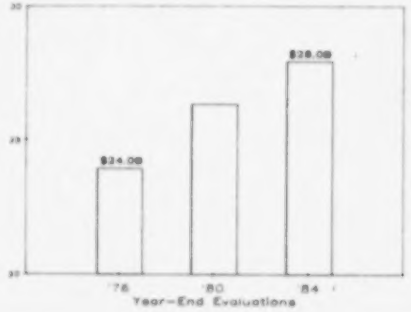
THE FACTS: Policyholder dividends, although not "losses", are price discounts to customers that are legitimate business expenses, deductible from income. This treatment follows that dictated by statutory accounting procedures developed by the National Association of Insurance

6 1976 INDUSTRY RESERVES FELL SHORT



Calendar Year 1976 Loss Reserves ($ Billions) *The reserves set aside at year-end 1976 proved to be nearly $10 billion (20%) short eight years later.*

7 1976 GENERAL LIABILITY RESERVES FELL SHORT



General Liability Incurred Loss Development—1976 ($ Billions) *Estimated costs of general liability claims incurred through 1976 proved to be $4 billion too low by year-end 1984.*

Commissioners and is consistent with generally accepted accounting principles as articulated by the Financial Accounting Standards Board (FASB). The opinion of the independent accounting firm of Coopers & Lybrand supporting this treatment may be found in the Appendix.

The charge that policyholder dividends should not be treated as expenses could just as easily—and just as misleadingly—be applied to any price discount a company offers its customers to encourage the purchase of the company's product or service. And that's what policyholder dividends are: a price discount. When manufacturers offer a $10 refund on the price of a coffeemaker or a $500 rebate on the price of a car, they are not distributing profits; rather, they are incurring an expense that is, in effect, a price cut. As with manufacturers offering price discounts, policyholder dividends are appropriately recognized as an insurer expense that reduces profits. Policyholder dividends are not a distribution of profits.

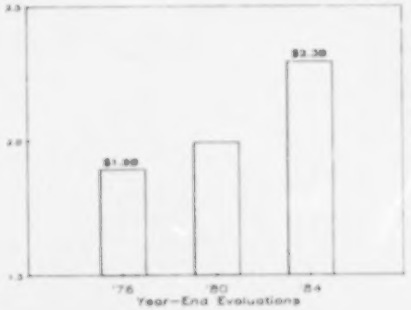
Policyholder dividends are unlike dividends to stockholders. Policyholder dividends represent a portion of gross revenues that a company has designated for return to its policyholders. Many insurer managements pay dividends to policyholders as a competitive tool to retain business. Also, many insurers grant dividends to policyholders whether they are profitable or not, treating the practice as a necessary cost of doing business. (See chart 10.)

On the other hand, dividends to stockholders of any business corporation represent a distribution to its owners of a portion of current or past earnings, based on each owner's total holdings. Unlike policyholder dividends, stockholder dividends do not offset income. They are charged directly to net worth.

CHARGE: The property/casualty insurance industry defines "income" to exclude certain items, such as realized capital gains. Insurers report operating income, rather than net after-tax income, to show they had losses when they really made money.

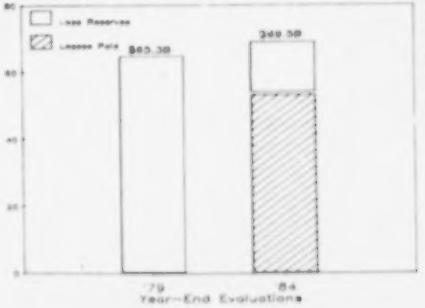
THE FACTS: This charge is false. Every quarter, statistics compiled and released by ISO highlight net after-tax

8 1976 MEDICAL MALPRACTICE RESERVES FELL SHORT



Medical Malpractice Incurred Loss Development — 1976 ($ Billions)
Estimated costs of medical malpractice claims incurred through 1976 proved to be $400 million too low by year-end 1984.

9 1979 INDUSTRY RESERVES FELL SHORT



Calendar Year 1979 Liability Loss Reserves ($ Billions)
The reserves set aside at year-end 1979 for liability lines were more than $4 billion (6%) deficient just five years later.

income, which includes realized capital gains, as well as all other components of income.

For example, a widely-distributed November 26, 1985 news release from ISO and the National Association of Independent Insurers began with the following statement:

"The nation's property and casualty insurance industry's consolidated net after-tax income totaled $1.49 billion for the first nine months of 1985, up 118 percent from the nine-month 1984 net income of $685 million."

This news release went on to document various components of net after-tax income, including underwriting results, investment results and pre-tax operating income—all important and commonly-used measures of an insurer's business.

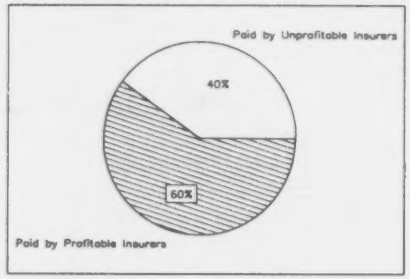
Pre-tax operating income is important to financial analysts, since it is free of the unpredictable and erratic swings exhibited by realized capital gains over a short period. While the total return on net worth (represented by net after-tax income, including realized capital gains) is the more proper measure when comparing insurer results with other commercial and industrial enterprises, operating income is a more precise reflection of the company's insurance operations—how well it is doing in its basic business.

The components of operating income are underwriting income (after policyholder dividends) and investment income (net of investment expenses). While realized capital gains are considered in the determination of taxable income, they are not part of operating income. The opinion of the independent accounting firm of Coopers & Lybrand supporting this treatment may be found in the Appendix.

Realized capital gains reflect a decision to sell assets. Companies may realize capital gains to offset operating losses and/or to utilize federal income tax credits. Prior to 1983, the industry's realized capital gains were not significant, relative to net income after taxes. But in 1984 and 1985, without unprecedented realized capital gains, net income after taxes for the industry would have been a net *loss*. **(See chart 11.)**

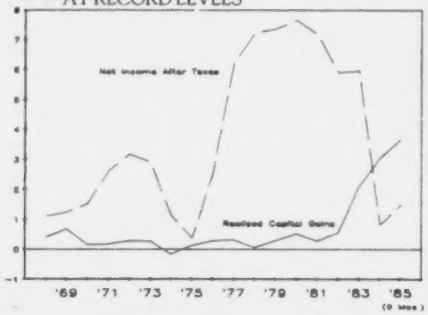
No insurer can guarantee large realized capital gains in a future year. Therefore, operating income has become the common measure for evaluating the success—or lack thereof—of an insurance company's operation.

10 WHO PAID POLICYHOLDER DIVIDENDS IN 1984?



Insurers with a negative return on net worth paid 40% of 1984 policyholder dividends.

11 INSURERS REALIZED CAPITAL GAINS AT RECORD LEVELS



Realized Capital Gains and Net Income After Taxes ($ Billions) *Only the unprecedented levels of gains from the sale of assets allowed the industry to show positive net income after taxes in 1984 and 1985.*

CHARGE: In 1984, property/casualty insurers earned about a 3% rate of return on net worth. That is too low. However, if their premium had been 5% higher, they would have earned a rate of return on net worth of about 13%. In 1985, insurers' return on net worth rose to an estimated 7%. If the effects of dividends to policyholders and unusually high hurricane losses in 1985 were removed, the industry's return on net worth in 1985 would have been about 13%, the average for all American industries.

THE FACTS: The 3% return on net worth quoted by critics for 1984 is wrong. More importantly, the conclusion that an additional 5% of premium would add 10 points to that return is also wrong. Similarly, the estimated 7% return on net worth for 1985 is too high. More importantly, the adjustment to the 1985 return, adding 6 points to the estimated value, is inaccurate, inappropriate and misleading.

First, the 3% rate of return quoted by critics for 1984 is wrong. The actual figure is 1.7%. Second, an additional 5% of premium would have added about 6 points to the return on net worth. This 6-point increment is based on the conservative assumption that fixed expenses will not grow at all despite the increased revenues. If one assumes growth in fixed expenses, the additional return is 5 points.

With regard to 1985, although the critics' adjustments are unsupported, it appears that policyholder dividends have been added back into income (incorrectly raising the return by 3 points) and *all* catastrophe losses have been removed (incorrectly adding another 3 points to the return). The proper adjustments to calculate a hypothetical industry rate of return—for a year with normal events—include removing the effect of all unusual events—not only unusual catastrophe losses, but unusual realized capital gains as well. These adjustments would lower the 1985 return on net worth by about 3 points—not raise it by 6 points.

Dividends to policyholders are premium discounts to customers, rather than a distribution of profits to owners. They are properly considered as a legitimate business expense in the determination of the rate of return on net worth. Removing the effects of policyholder dividends on income is inaccurate. **(See page 20.)**

Catastrophe losses are defined as events that cause more than $5 million of insured losses. 1985 was indeed a year of unusually high catastrophe losses, totaling $2.8 billion or about 2.1% of premium. The average annual catastrophe loss over the last 10 years has been 1.3% of premium. **(See chart 12.)** To calculate the return on net worth as if 1985 had been a more typical year, an average annual catastrophe loss amount should be substituted for 1985's actual catastrophe losses. Using 1.3% rather than 2.1% to smooth the dollar value of catastrophe losses would raise the return on net worth by approximately 1 point.

But to restate the 1985 return as a more typical year, one should also adjust the component of 1985 insurer profitability that showed the most atypical result—realized capital gains. The average annual realized capital gain over the last 10 years has been 0.51% of assets, while 1985 realized capital gains are estimated to be $5.3

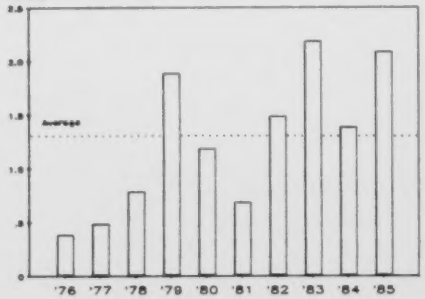
billion or 1.75% of assets—more than three times the 10-year average. **(See chart 13.)** Substituting the average capital gains for the 1985 amount reduces the return on net worth by 4 points.

Using a long-term average for both catastrophe losses and realized capital gains lowers the return on net worth by approximately 3 points.

Not only do the critics err in how they apply adjustments, but their estimate of a 7% return on net worth for 1985 is too high. This estimate appears to include both unrealized capital gains, as well as an incorrect amount for federal income tax credits as income. Unrealized capital gains are not income and should not be included as such in a calculation of the 1985 return on net worth. The latest estimate of 1985 federal income tax credits is $1.9 billion, rather than the $3.5 billion that appears to be included in the estimate of 7%. Correcting both of these errors would lower the return by several additional points.

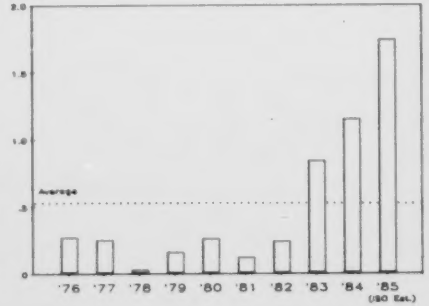
These errors have been partially recognized by critics who, more recently, quoted a revised return on net worth of 6% for 1985—still an overestimate.

12 CATASTROPHE LOSSES CANNOT BE IGNORED



Catastrophe Losses (% of Earned Premium) *Catastrophe losses have varied over the last 10 years, averaging 1.3% of earned premium. Use of a long-term average for catastrophes is an appropriate adjustment in the calculation of expected return on net worth. Total exclusion of all catastrophe losses in 1985 is wrong in determining 1985 profitability for the property/casualty industry.*

13 REALIZED CAPITAL GAINS VARY OVER TIME



Realized Capital Gains (% of Assets) *Realized capital gains have grown in recent years to unprecedented levels. Use of a long-term average of realized capital gains is an appropriate adjustment in the calculation of expected return on net worth. Inclusion of the record levels of realized capital gains in a calculation of the 1985 return is misleading in determining potential profitability.*

ACCUSATION

Price increases are excessive. Losses are not the problem.

CHARGE: The insurance industry needed only a 12-15% increase in written premium in 1985 in order to achieve a 13-15% return on net worth in 1986. Given the magnitude of the premium increases in 1985, no additional price increases are needed in 1986.

THE FACTS: No reasonable set of assumptions could support the above statements. It is not plausible that a 12-15% premium increase in 1985 could produce such a high rate of return in 1986. This analysis cannot refute the specific assumptions or calculations underlying the critics' charges since no supporting data have been provided.

Based on an ISO analysis, if industry written premiums had increased only 12-15% in 1985, further increases in excess of 30% would be required in 1986 to achieve a 13% return on net worth. An overall premium increase of this magnitude would be far larger than any ever achieved by the insurance industry.

Given the estimated 20% premium growth that occurred in 1985, ISO forecasts there will be a smaller increase in 1986. Assuming a 17.5% increase for 1986, ISO projects that 1986 industry returns on net worth will rise. Under reasonable assumptions for loss growth, investment income, realized capital gains and taxes, the 1986 return on net worth will be only 8-9%, which is far below the typical returns for most other U.S. industries and below the median result for the Fortune 500 in each of the last 10 years.

The following facts support the ISO analysis and forecasts.

(1) Recent insurance industry returns on net worth have been low—below 2% for 1984, with modest improvement, at best, in 1985. Roughly a 10-point increase in return on net worth would be required to reach the 13-15% range hypothesized for 1986.

(2) Industry losses have continued to escalate rapidly, rising 15% in the first nine months of 1985. The full-year increase in losses will be at least as high.

The charge that no additional price increases are needed in 1986 is false. If the industry implements no increases in 1986, a return on net worth of only 5% could be expected—and 1987 returns would be even lower. The beginning of another downturn so soon after the longest and most severe downturn in the history of the industry would seriously threaten the industry's ability to make future claim payments.

CHARGE: Insurance premiums are increasing so dramatically today solely because of prior inadequate prices. Increasing losses are not the problem.

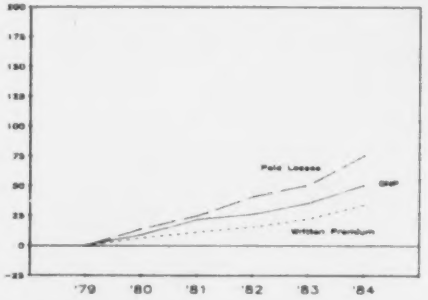
THE FACTS: This charge is incorrect. No one can deny that insurers reduced prices far below the level needed to cover the costs of policies written. However, in the past five years, growth in property/casualty losses has far exceeded the country's economic growth as measured by GNP.

During 1979-1984, GNP grew 50% while written premium increased only 34%, or 2.4 points per year *slower* than the average annual GNP growth rate. On the other hand, paid losses grew 76%, or 3.4 points per year *faster* than GNP. **(See chart 14.)**

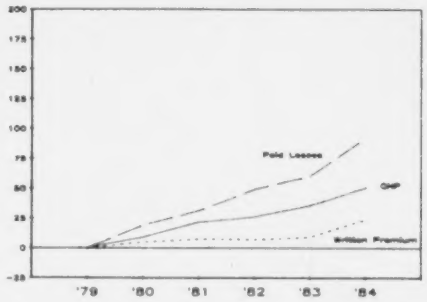
Moreover, the increase in losses was not uniform across all lines of insurance. Commercial lines paid losses grew 92% while personal lines

LOSSES GREW FASTER THAN PREMIUMS, ESPECIALLY FOR COMMERCIAL LIABILITY LINES

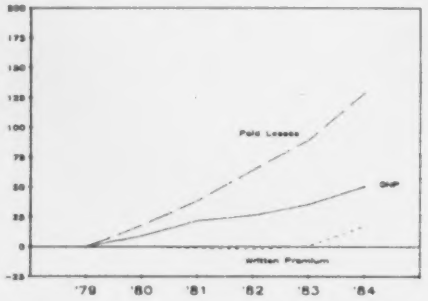
Since 1979, paid losses have grown at a faster rate than either GNP or premiums. The problem is more severe for commercial lines, especially the commercial liability lines.



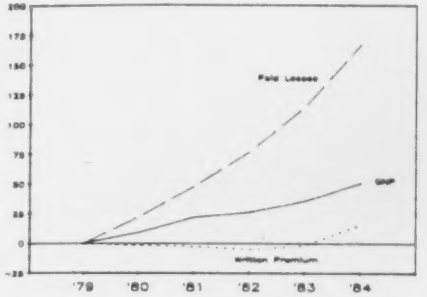
14
Loss Growth and Premium Growth vs. GNP (%): All Lines



15
Loss Growth and Premium Growth vs. GNP (%): Commercial Lines



16
Loss Growth and Premium Growth vs. GNP (%): Commercial Liability



17
Loss Growth and Premium Growth vs. GNP (%): General Liability & Medical Malpractice Combined

paid losses increased 62%, and commercial liability paid losses increased 130% during the period—well over double the GNP growth rate. **(See charts 15 and 16.)**

Finally, general liability and medical professional liability paid losses have grown 167% over the five-year period—more than triple the GNP growth. **(See chart 17.)** From 1979 to 1984, paid loss growth averaged 22% a year—13 points more than the average annual GNP growth rate. **(See chart 18.)**

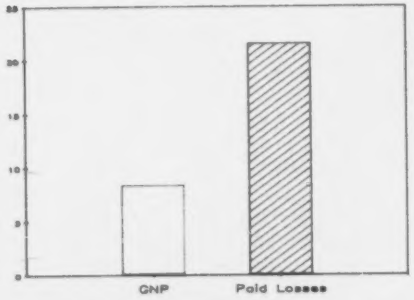
The Administrative Office of U.S. Courts reports that product liability suits filed in U.S. District Courts increased from 1,600 in 1974 to more than 13,500 in 1985—a growth rate of 22% per year. **(See chart 19.)** Very large awards are becoming much more common. Jury Verdict Research, Inc. reports that the number of million-dollar verdicts in the U.S. has increased each year, from 24 in 1974 to over 400 in 1984. **(See chart 20.)**

One aspect of the problem of increasing losses is the accompanying litigation costs. The Institute for Civil Justice studied asbestos litigation and found that a disproportionate share of the expenditures on these claims does not reach the victims. Specifically, only 37% of costs in asbestos litigation become net compensation to victims. **(See chart 21.)**

While current availability and affordability problems are certainly due in part to past price reductions, a major contributor to the problems has been the significant increase in losses. From 1979 to 1984, policyholders had the benefit of low insurance price levels that did not keep pace with losses. But as a result, the insurance industry experienced below-average returns on net worth relative to the Fortune 500 companies in every year since 1979.

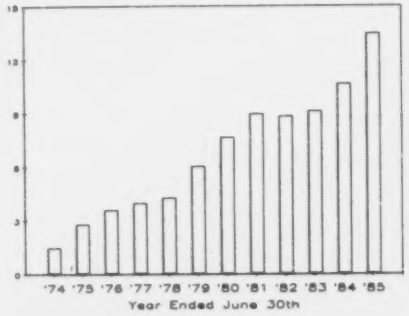
The large premium increases occurring now, particularly for the commercial liability lines, will not recoup past losses nor make up for recent substandard returns. Such increases are needed simply to bring insurance prices in line with the costs of policies written today.

18 LOSS GROWTH OUTPACES ECONOMIC GROWTH



General Liability & Medical Malpractice Losses vs. GNP—1979-84 (Annual % Change) *For the past five years, the average rate of growth in general liability and medical malpractice paid losses was 22% vs. a 9% GNP growth rate, a 13-point annual gap.*

19 LITIGATION EXPLOSION



Product Liability Lawsuits (Thousands) *Since 1974, the number of product liability lawsuits filed in U.S. District Courts has increased more than eight-fold. Source: Administrative Office of U.S. Courts.*

CHARGE: The 1985 written premium increase of 71% for general liability insurance was excessive. If insurers had not slashed liability rates a few years ago, they would have earned handsome profits.

THE FACTS: The 1985 premium increase was not excessive. Even after that increase, current general liability premium levels are still inadequate when compared with current general liability losses.

The 1984 general liability written premium of $6.5 billion was no greater than the 1978 written premium. But from 1978 to 1984, losses and loss adjustment expenses incurred increased 74%, from $4.3 billion to $7.5 billion. (See chart 22.) Even after including the estimated 1985 increase, written premium has grown at an annual rate of only 8% since 1978, while losses have grown at an annual rate of 14%.

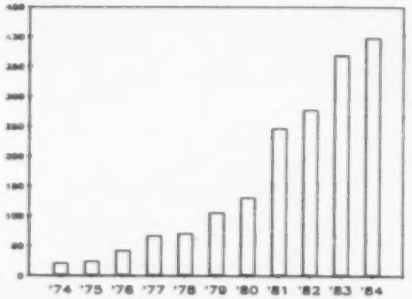
A.M. Best Company estimates the 1985 combined ratio[3] for general liability at 144. At that level, even with a reasonable estimate of anticipated investment income, the general liability lines will lose money. With an estimated annual 8½% interest rate, historical payout patterns for general liability and the A.M. Best combined ratio estimate for 1985, insurers lost 7¢ on every dollar of general liability premium written in 1985. Obviously, the 1985 increase was not sufficient.

One critic has charged that "general liability rates of return on net worth" would have averaged 30% per year from 1976 to 1983, if insurers had not cut premiums. This hypothetical rate of return is flawed by unrealistic assumptions.

- For all lines combined, it assumes that the ratio of earned premium to net worth is 2:1. The actual average for 1976 through 1983 was 1.6:1.
- Further, it assumes that the hypothetical 2:1 earned premium to net worth ratio is

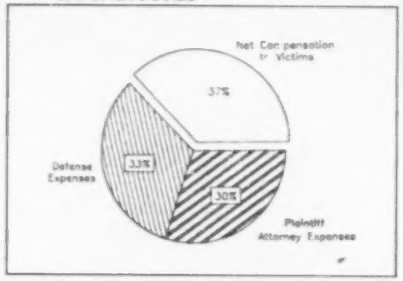
[3]*Combined ratio = incurred losses and loss adjustment expenses divided by net earned premium plus other underwriting expenses divided by net written premium plus dividends to policyholders divided by net earned premium.*

20 NUMBER OF HUGE VERDICTS INCREASING



Million-Dollar Verdicts *From 1974 to 1984, the number of million-dollar verdicts rose dramatically. Source: Jury Verdict Research, Inc., Solon, Ohio.*

21 VICTIMS RECEIVE ONLY 37% OF ASBESTOS CLAIMS EXPENDITURES



Average Expenditures per Tried Asbestos Claim (%) *The Institute for Civil Justice has found that only 37% of asbestos claims expenditures become net compensation to victims.*

the same for general liability as for all lines combined. In a line like general liability, claims remain outstanding for long periods of time while legal standards change; a prudent insurer would therefore require more net worth to support each dollar of general liability premium than for most other lines.

- In rewriting history, the critics assume that, had premiums been greater, *all* the additional premium revenue would have been profit. This assumption ignores the fact that, at a minimum, commissions and premium taxes would be paid and income taxes would rise (or credits decrease).

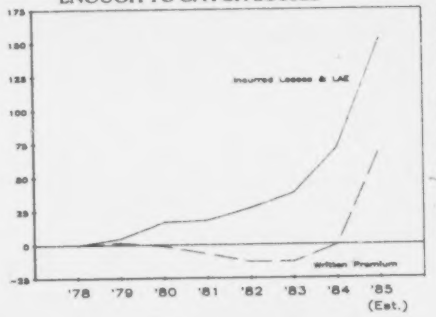
Thus, the conclusion that the "general liability return on net worth" would have been 30% is inaccurate.

CHARGE: Since, for medical malpractice, the industry's paid losses are less than their investment income, this line can be treated on a "pay as you go" basis.

THE FACTS: This charge has two flaws. First, the figures are inaccurate and incomplete; the industry's paid losses alone for medical malpractice are substantially greater than investment income, even without consideration of paid loss adjustment expenses. Second, even if the figures were accurate and complete, the charge is irrelevant. It is inappropriate to consider only actual payments without recognizing future liabilities for injuries that have already occurred but for which the related claims are not yet settled. For long-tail lines like medical malpractice, these claims take many years to settle.

For 1984, A.M. Best reported $970 million in medical malpractice paid losses and $440 million in paid loss adjustment expenses (monies expended in the investigation and settlement of claims), for a total of $1.4 billion.

22 1985 GENERAL LIABILITY PREMIUM GROWTH NOT ENOUGH TO CATCH LOSSES



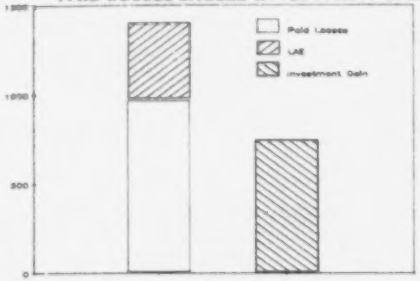
General Liability Premium Growth vs. Loss Growth (%) *1985's large premium growth for general liability was not enough to bring premiums in line with 1985 general liability losses and loss adjustment expenses. And, since 1978, the rate of growth in losses is nearly double that of premiums.*

This compares with only $750 million of net investment gain. **(See chart 23.)** In addition, underwriting expenses and policyholder dividends of $300 million were paid in 1984.

Even if 1984 paid losses had been less than investment income, comparing the two is naive. An analogy can be made to a pension plan with the vast majority of participants in their 30's and 40's. For many years, premiums paid into the plan will far exceed benefits paid out, but it is quite obvious that the liability for future benefit payments is growing each year and must be funded.

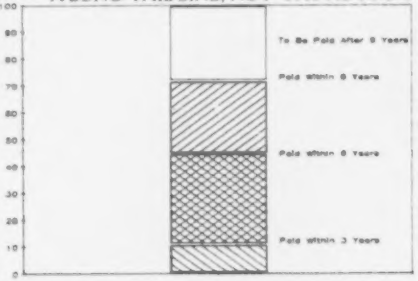
Similarly, medical malpractice claims often take years to emerge and additional years to be litigated. Claims paid out the first year are miniscule, and even after several years, only a small percent of ultimate losses are paid out. For 1976, the year for which the most complete and mature data is available, only 1% of total estimated losses were paid in the first year, only 11% in the first three years and only 72% even after nine years **(See chart 24.)** The percentages are similar for other years examined. To conclude anything about the profitability of this line on the basis of paid losses is like saying that the Social Security system is properly funded simply because more money was collected this year than was paid out this year.

23 CRITICS' CHARGES FALSE: MEDICAL MALPRACTICE PAID LOSSES EXCEED INVESTMENT GAIN



Medical Malpractice Insurers' Paid Loss & Loss Adjustment Expense vs. Investment Gain ($ Millions)
For 1984, investment gain for medical malpractice insurance is significantly lower than loss and loss adjustment expenses paid. Critics falsely contended the opposite.

24 MEDICAL MALPRACTICE INSURANCE: A LONG-TAIL LINE, NOT "PAY AS YOU GO"



1976 Medical Malpractice Claims: Percent of Ultimate Losses Paid
After nine years, only 72% of 1976 medical malpractice losses were paid. Claims often take years to emerge and additional years to litigate.

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ACCUSATION

Insurers are making substantial profits and paying no taxes. There's nothing fundamentally wrong with industry profitability. This is just a typical cyclical downturn.

CHARGE: The stock index of property/casualty insurers rose by 50% during 1985, almost double the rise of the general stock market. This is hardly indicative of a troubled industry.

THE FACTS: The fact that property/casualty stock prices, as measured by the A.M. Best Company's property/casualty stock index, outperformed the rest of the stock market is no indication that this industry is profitable. Investors expect improvements in rates of return for property/casualty insurers, but investor expectations are merely that—*expectations*. They do not guarantee results.

Signs of a firming in insurance premiums (especially for commercial lines) began to emerge at the end of 1984. This price strengthening continued throughout 1985 and shows no sign of abatement in 1986. It is clear that sophisticated institutional investors believe that insurers have regained control of their financial destinies and that earnings will improve. But investor expectations do not guarantee future results, and investor behavior does not necessarily correlate with future earnings of the industry.

CHARGE: Property/casualty insurers had net income of $75 billion over the last 10 years. This is a huge amount of money to make. And they paid no taxes.

Note: The $75 billion figure in the critics' charge is based on a fact sheet prepared for the House Ways and Means Committee by the General Accounting Office. The GAO produced a chart that contained the following figures for the property/casualty insurance industry.

1975-1984 (In billions)

Underwriting Gains (Loss)	($ 45.8)
Investment Gains	121.0
Net Gains	$ 75.2

THE FACTS: The $75 billion figure is not net income. It *excludes* policyholder dividends paid and *includes* unrealized capital gains. Net income after taxes averaged $5.1 billion per year, for an average return on net worth of 10.9%. The 10.9% figure is lower than that of the Fortune 500 companies. And insurers' tax credits are based on underwriting losses and the tax status of their investments.

Some critics have used the GAO's figures to reach erroneous conclusions. The underwriting loss shown excludes policyholder dividends paid, and since policyholder dividends are a cost of doing business, they must be deducted from income. (See page 20.)

Investment gains, as shown, include unrealized as well as realized capital gains. Unrealized capital gains flow directly to surplus and do not affect income until realized. A restatement of the 1975-84 totals, with the proper adjustments for policyholder dividends and unrealized capital gains, follows:

PROPERTY/CASUALTY INSURANCE INDUSTRY INCOME, 1975-1984 (In billions)

Underwriting Gain (Loss) After Policyholder Dividends	($ 90.0)
Investment Income	103.7
Operating Income	$ 43.7
Realized Capital Gains	7.7
Net Income (Before Federal Income Tax)	$ 51.4

Property/casualty insurers received a total of $125 million in federal income tax credits during 1975-1984. Thus, industrywide net income after tax for the 10-year period averaged $5.1 billion per year, not an excessive return. Over the 10-year period 1975-1984, returns on net worth ranged from 1.7% to 19.0%, averaging 10.9%. A comparison with other industries follows:

RETURNS ON NET WORTH, 1975-1984

	P/C Insurance	Diversified Financial	Banks	Fortune 500
Low:	1.7%	8.3%	11.5%	10.7%
High:	19.0	17.5	14.1	15.9
Range:	17.3	9.2	2.6	5.2
Average:	10.9	12.8	12.6	13.2

The property/casualty insurance industry has had the lowest average return, while experiencing the greatest variability of all the industries listed. **(See chart 25.)** This occurs despite the economic theory that increased variability should be rewarded with greater average returns.

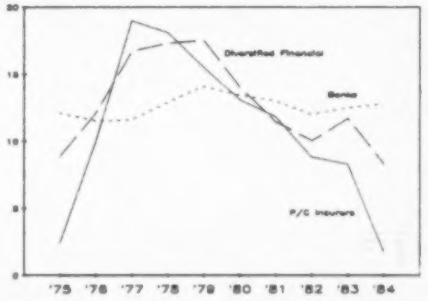
While some critics have argued that the property/casualty insurance industry is a low-to-average risk business, the Majority Report of the Advisory Committee to the NAIC Task Force on Profitability and Investment Income (January 1983) concluded that "the property-casualty insurance business is riskier than the average business in the American economy."

Although property/casualty insurers received a total of $125 million in federal income tax credits during 1975-1984, they paid $21 billion in state and local taxes, licenses, and fees other than payroll taxes. The 1985 federal income tax credit is estimated at under $2 billion, while state and local taxes paid are estimated at over $3 billion.

Net federal income tax credits have accumulated for several reasons. In eight of the past 10 years, the industry posted underwriting losses. Since the 10-year underwriting loss was $60 billion, the positive net income of $51 billion came from investment gains. In achieving this income, property/casualty insurers, like other businesses, benefited from various incentives provided by the federal tax system to help the country achieve certain economic objectives.

For example, to help state and local governments raise money through the sale of bonds, Congress has determined that interest

25 INDUSTRY RETURNS ARE VOLATILE OVER TIME



Return on Net Worth: Property/Casualty Insurers vs. Other Industries (%) *Returns on net worth for property/casualty insurers are much more variable than those for other industries. Over the past 10 years, the average rate of return for property/casualty insurers (10.9%) has been below that of the Fortune 500 companies (13.2%), while exhibiting much more variation.*

on such bonds is exempt from federal taxes. This enables such bonds to be sold with interest rates below the market rate, reducing interest costs ultimately paid by state and local taxpayers. Insurers could have earned higher interest income (on taxable bonds) and paid taxes on that interest income, inflating their federal tax bills but leaving state and local governments without a source of low-cost financing.

Over the last six years, 40% of the industry's net investment income has come from non-taxable bonds. Favorable tax treatment also exists for dividends on equities held by insurers, which have accounted for 20% of the industry's net investment income. In addition, property/casualty insurers (like all investors) benefited from reduced tax rates on realized capital gains.

It is inappropriate to criticize insurers for acting in compliance with tax laws and public policy.

CHARGE: This is a typical cycle. The property/casualty industry will recover quickly, just as it has in past cycles.

THE FACTS: This cycle is clearly not typical. The results of the recent past demonstrate that the industry is experiencing anything but a "typical" cyclical period. Underwriting losses, operating losses, combined ratios, the number of insolvencies and the number of companies targeted for immediate regulatory attention were all at record highs in 1984, while the industrywide return on net worth was at an all-time low. And reinsurers, on whom insurers depend as never before, have been seriously weakened.

The 1984 underwriting loss was $21.5 billion. Prior to this cycle, the record underwriting loss was $4.2 billion in 1975. **(See chart 26.)** The 1984 operating loss was $3.8 billion. The previous record was $0.3 billion in 1975. **(See chart 27.)** The 1984 combined ratio was 118.0. Prior to this cycle, the record was 107.9, again in 1975. **(See chart 28.)**

In 1969, the National Committee on Insurance Guaranty Funds began to collect data on insolvencies that trigger state guaranty funds. Until last year, the record number of insolvencies in any two-year period was 25. During 1984-85, there were 40 insolvencies; and the books on 1985 insolvencies are not yet closed. **(See chart 29.)**

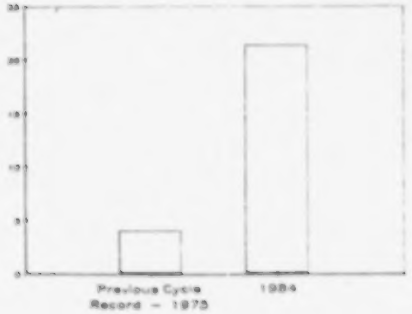
The National Association of Insurance Commissioners (NAIC) developed an early warning system to alert regulators to potential insolvencies. In discussing the 1985 test results, Iowa Insurance Commissioner Bruce W. Foudree, former President of the NAIC, said that 215 property/casualty insurers had been targeted as being in need of immediate regulatory attention under the NAIC early warning system—"the most ever and a 73% increase over last year."

On the basis of bottom-line results, the 1984 return on net worth was 1.7%, despite a record $4.8 billion of realized capital gains and tax credits. The previous low return on net worth of 2.4% occurred in 1975, when the sum of tax credits and realized capital gains was only $0.7 billion.

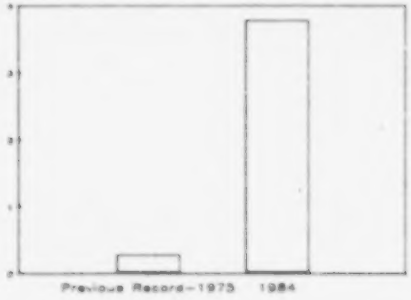
One of the most important differences between this down cycle and all previous ones is its length. This time, the combined ratio worsened for seven consecutive years beginning in 1978. Previously, the longest continuous

A TYPICAL CYCLE?

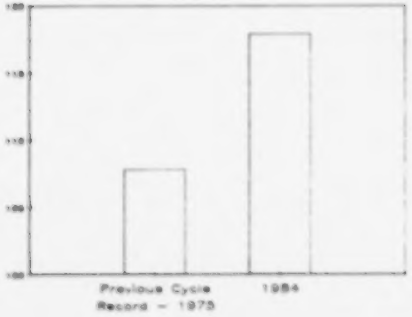
By several measures — underwriting loss, operating loss, combined ratio, and insolvencies — it is clear that the cycle that bottomed in 1984 was far more severe than any previous one.



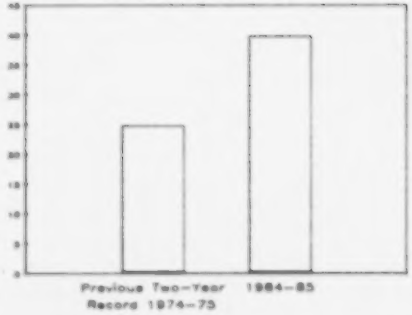
26
Underwriting Losses ($ Billions)



27
Operating Losses ($ Billions)



28
Combined Ratios



29
Insolvencies Covered by State Guaranty Funds

period of deteriorating combined ratios was for the five years 1960 through 1964. During that period, however, the combined ratio worsened by only five points; in this cycle, it deteriorated by 21 points.

Another indicator of the depth of this cycle is the number of insurers receiving reductions in any year from their A.M. Best rating of A+. That number increased from 23 in 1982, to 61 in 1983, to 80 in 1984 and finally to 149 in 1985. **(See chart 30.)** In 1985, only 24% of the companies rated received an A+, compared with an average of 39% in 1976 and 1977 following the last adverse underwriting cycle.

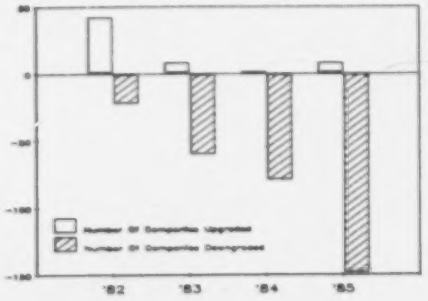
The property/casualty insurance industry is now more dependent on the reinsurance mechanism* than ever before. During 1979-1984, reinsurance recoverable (monies owed to insurers by their reinsurers) more than doubled, while surplus grew 50%. **(See chart 31.)** For reinsurers themselves, the amount recoverable from their reinsurers more than tripled during this period, while their surplus grew 73%. **(See chart 32.)** During this period, premiums for the industry increased 30%, while reinsurance premiums increased 54%. At the same time as dependence on reinsurance rapidly increased, reinsurers' financial condition seriously eroded. The 1984 return on net worth for the entire insurance industry was nearly 2%, while it was negative 10% for reinsurers. In 1985, A.M. Best lowered the ratings of half the reinsurers rated.

For the past two decades, reinsurers' combined ratios have closely paralleled those of the property/casualty industry with the gap never exceeding 4½ points, except for the 6-point gap in 1965, the year of Hurricane Betsy. **(See chart 33.)** As recently as 1982, the two combined ratios were only one-tenth of a point apart. The gap grew to 6 points in 1983 and then to 13 points in 1984. Although this gap has begun to narrow in 1985, reinsurer combined ratios are still substantially worse than those for the entire property/ casualty industry.

Historically, personal and commercial lines results have been similar. Between 1967 and 1982, the difference between the combined ratios never exceeded 6 points. **(See chart 34.)** As recently as 1981, the ratios were only 2 points

*For a more thorough discussion of reinsurance, see the Appendix.

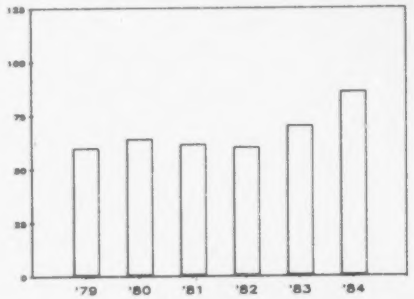
30 INSURERS' FINANCIAL RATINGS DOWNGRADED



A.M. Best's A+ Rating Reductions
A.M. Best's highest rating is an A+, which it gives to companies that it considers to be the most financially secure. In the last two years, A.M. Best has removed 229 companies from this category, while upgrading only 11.

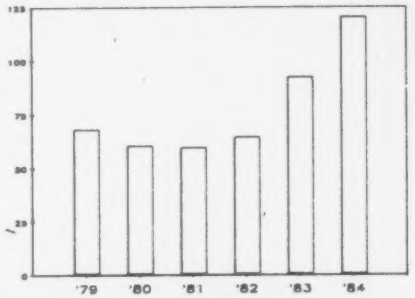
REINSURANCE RECOVERABLES GROWING

The entire property/casualty industry and reinsurers themselves have become more dependent on reinsurance. For the industry, reinsurance recoverable represented 85% of surplus in 1984, doubling in value from $26 billion in 1979 to $55 billion in 1984. For reinsurers, recoverables represented 120% of surplus in 1984, tripling in dollar value since 1979.



31

Industry Reinsurance Recoverable (% of Surplus)

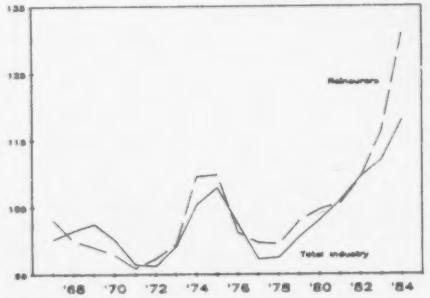


32

Reinsurers' Reinsurance Recoverable (% of Surplus)

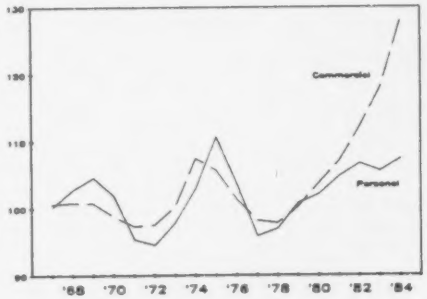
DETERIORATION GREATEST IN COMMERCIAL LINES AND REINSURANCE

Reinsurers have experienced significantly more severe combined ratios than the industry as a whole since 1983, a marked contrast to past cycles. Likewise, commercial lines combined ratios have skyrocketed recently, while those for the personal lines have been more stable.



33

Combined Ratios: Reinsurers vs. Total Property/Casualty Industry



34

Combined Ratios: Personal Lines vs. Commercial Lines

apart. Then in 1983, the gap grew to 12.5 points. In 1984, when it grew to over 20 points, those insurers writing predominantly commercial lines had a negative return on net worth. In 1985, the gap began narrowing but still stood at nearly 15 points for the year ended September 30, 1985.

An even greater concern for commercial lines insurers and reinsurers is that their combined ratios may be understated due to reserve inadequacy. Because of this, the combined ratios for these insurers could be worse than the record highs recorded.

Richard E. Stewart, former Superintendent of Insurance of the State of New York, discusses the current cycle in a December 1985 Marsh & McLennan *Commentary* article. In it, he writes, "...this is not just a routine turn in the underwriting cycle. It has structural as well as cyclical causes." He further notes, "Whereas economic inflation drove the casualty insurance crises of the mid-seventies, the current one is driven by terrible events and by changes in liability law." And he adds, "Insurance has met liability problems before. These are liability disasters. No exclusion is reliable, no excess level out of reach."

All these elements strongly support the conclusion that this is not just a "typical cycle" for the property/casualty insurance industry. Because reinsurers and commercial lines insurers have been hit harder, premium increases will fall unevenly, with some commercial liability policyholders experiencing very large increases. Because the industry's downturn lasted longer than ever before and because the depth of the downturn was worse than ever before, the recovery must be longer and stronger in order to achieve an adequate level of profitability for the industry.

ACCUSATION

Insurance is too expensive.

CHARGE: The total insurance bill in the U.S. will rise from 11.1% to more than 12% of disposable income in 1985—more than $300 billion—displacing personal federal income taxes as the third largest expense in the nation's budget. Only food and housing cost Americans more than insurance.

THE FACTS: These statistics are misleading. The $300 billion figure includes life, health, and accident insurance premiums as well as all property/casualty insurance premiums. The costs of life, health and accident insurance do not belong in a discussion of property/casualty insurance. Moreover, the inclusion of business insurance expenses is inappropriate when making comparisons to disposable income, which is a measure of personal income only.

Personal lines insurance premiums (for private passenger automobile and homeowners insurance) are estimated to be $64 billion in 1985, which would represent 2.3% of disposable income, the amount of 1985 personal income after taxes.

Insurance is not even the largest expense associated with owning either a car or house. In 1984, the Federal Highway Administration conducted a study on the cost of owning and operating typical vehicles in suburban Baltimore, Maryland. The study concluded that insurance was the third largest cost—behind vehicle cost depreciation, and gas and oil for most cars. For large and compact cars, it ranked fourth—behind vehicle cost depreciation, gas and oil, and also maintenance, accessories, parts and tires.

A 1983 countrywide study by the U.S. League of Savings Associations showed that the cost of insurance represents less than 3% of the monthly housing expenses faced by home purchasers in the United States. Insurance costs came in fourth—behind mortgage payments, real estate taxes and utilities.

There are many items that cost Americans more than insurance. One way to analyze relative costs is to examine the components of the nation's personal consumption expenditures, which are included in GNP. According to the Department of Commerce, personal consumption expenditures represent the market value of purchases of goods and services by individuals and non-profit institutions and the value of food, clothing, housing, and financial services received by them. Therefore, the components of personal consumption should be compared with personal lines premiums as follows:

1985 AMOUNT SPENT ($ BILLIONS)	
PERSONAL CONSUMPTION COMPONENT	
Food & Beverages	474
Housing	403
Motor Vehicles & Parts	168
Clothing & Shoes	156
Furniture & Appliances	129
Gasoline & Oil	92
INSURANCE PREMIUMS	
Personal lines insurance premiums[5]	64
Total property/casualty insurance premiums	142

The table indicates six components which are a greater proportion of consumer spending than property/casualty personal lines premiums.

[5]It should be noted that personal lines insurance premiums do not include premiums written on non-profit institutions. However, inclusion of premiums written on non-profit institutions with personal lines premium would have a minor impact and would not raise the total above any of the six personal consumption items listed above.

CHARGE: Property/casualty insurance premiums written rose by $24.6 billion in 1985, from $117.7 to $142.3 billion, while coverage decreased substantially. This works out to an increase of $105 per person for substantially less coverage.

THE FACTS: These figures are misleading. A.M. Best's estimate of the $24.6 billion increase is for all property/casualty premiums, not just personal lines premiums.

Personal lines premium (for the coverages purchased by individuals to protect their autos and homes) increased $6.7 billion, or 11.7% in 1985, an increase of $28 per person, not $105. The 11.7% increase in personal lines premiums in 1985 approximated the 13% increase in personal lines losses. ISO estimates that personal lines paid losses and loss adjustment expenses increased $5.5 billion in 1985, equivalent to an average $23 payment per person. After all losses and expenses, insurer underwriting loss for personal lines was over $1 billion more in 1985 than in 1984.

There do not appear to be significant marketplace problems in the personal lines. Large premium increases are the exception rather than the rule, and restrictions in coverage have been rare.

Most of the 1985 written premium increase was in commercial lines, which increased $17.8 billion or 30%, as the industry reacted to the growth in losses for these lines.

These increases in commercial insurance loss costs are a matter of concern, since they are outpacing the costs of other goods and services. It is precisely this point that has led industry leaders, businesspersons, legislators, regulators and consumers to investigate methods of reducing the upward spiral in insured losses.

APPENDIX

DISCUSSION OF REINSURANCE

Reinsurance is essentially an insurance transaction whereby the reinsurer, for a premium, agrees to indemnify the ceding insurer or reinsured against all or part of the loss which the latter may sustain under its policies of insurance. It is often described as the insurance of insurance companies because it provides reimbursement for an insurer's losses under policies covered by the reinsurance contract. Reinsurance is purchased by the primary or excess ceding insurer for its own benefit so that it can spread its risks and limit its own liability from large or catastrophic losses. The usual reinsurance contract does not involve the policyholder, who looks only to its insurer for defense and indemnity against loss.

Reinsurance was developed to provide capacity essential to the continued growth of the direct insurance industry. In addition to capacity, reinsurance is purchased by a primary insurer to (1) reduce exposure to liability on particular risks, (2) protect against accumulations of losses arising out of catastrophes, (3) reduce total liabilities to a level appropriate to its premium volume and capital, (4) reduce exposure to certain and possibly more hazardous lines of business or alter its "mix" of business, (5) help stabilize operating results, and (6) obtain assistance with new concepts and lines of insurance.

Reinsurance contracts are shaped to meet the specific needs of the ceding insurer . . . There are no standard reinsurance contracts; there are two basic types which are used and adapted to accommodate the buyer's business. A reinsurance *treaty* is a broad and often automatic agreement that covers some portion of a particular class or classes of business, i.e., the ceding insurer's entire workers' compensation or property book of business. In contrast, a *facultative* agreement covers a specific risk of the ceding insurer and requires the insurer and reinsurer to agree on terms and conditions on a contract-by-contract basis. Both treaties and facultative agreements may be based on a *pro-rata* distribution where the two parties share proportionately in premiums and losses. The agreements may also be written on an excess basis, where only the losses of the insurer in excess of a predetermined amount, known as the "retention", are reinsured.

Reinsurance Association of America statement before the House Subcommittee on Commerce, Transportation and Tourism, September 19, 1985.

Coopers
&Lybrand

certified public accountants

1251 Avenue of the Americas
New York, New York 10020

telephone (212) 536-2000
telex 126496
cables Coolybrand

in principal areas of the world

February 12, 1986

Insurance Services Office Inc.
125 Maiden Lane
New York, NY 10038

Gentlemen:

You have requested our opinion on the appropriate accounting by property and liability insurance companies for (1) dividends to policyholders and (2) realized gains and losses on investments. Our opinions expressed herein do not relate to assessment enterprises or fraternal benefit societies which may employ different accounting principles.

Generally accepted accounting principles for property and liability insurance companies are set forth in the Statement of Financial Accounting Standards No. 60 (the Statement), "Accounting and Reporting by Insurance Companies". The Statement contains the guidance for our views on the transactions set forth above which are:

Dividends to Policyholders

In our opinion, generally accepted accounting principles for property and casualty insurance companies require that dividends to policyholders be charged to operations.

Realized Gains and Losses on Investments

In our opinion, generally accepted accounting principles for property and casualty insurance companies require that realized gains and losses on all investments (including, but not limited to, stocks, bonds, mortgage loans, real estate and joint ventures) be reported in the income statement below operating income and net of applicable income taxes.

Very truly yours,

Coopers & Lybrand

APPENDIX B.—PREPARED STATEMENT OF DANIEL N. MYERS, VICE PRESIDENT, GOVERNMENT RELATIONS, AND GENERAL COUNSEL, NATIONAL LP-GAS ASSOCIATION, ARLINGTON, VA

National LP-Gas Association • 1235 Jefferson Davis Highway • Arlington, Virginia 22202 • 703-979-3343

March 31, 1986
File: 340

The Honorable Nichols Mavroules
Chairman
Subcommittee on General Oversight and The Economy
Committee on Small Business
U. S. House of Representatives
Washington, D.C. 20515

Dear Chairman Mavroules:

The National LP-Gas Association noted your field hearing on the subject of liability insurance and small business. As this is a subject of critical importance to the small business members of this industry, we respectfully request that you accept this statement and enclosures and that they be incorporated into the record of your hearing.

The members of the National LP-Gas Association (NLPGA) represent a cross-section of American business: from the largest producers of LP-gas (principally propane gas), a light hydrocarbon derived from crude oil refining and natural gas fractionation, to the smallest retailers, these 4000 member companies supply an essential fuel used by millions of homeowners for heating, cooking, and water heating. They all have been severely and seriously affected by the current crisis in insurance pricing and availability.

FEDERAL LAW ADDS TO PROBLEM

Although the extent of the impact of this crisis varies significantly according to each individual company's financial size and accident history, its effects have been exacerbated by legislation passed by Congress in 1980. Section 30 of the Motor Carrier Act of 1980 mandated that carriers of hazardous materials maintain certain minimum levels of financial responsibility. On January 1, 1985, following a five year phase in period, the full levels of financial responsibility took effect. As required by Section 30, carriers of propane gas and other hazardous materials in bulk, defined by the U.S. Department of Transportation as cargo tanks in excess of 3500 gallons water capacity, must maintain $5 million financial responsibility regardless of whether the cargo tank is operated in interstate or intrastate commerce. Cargo tanks of less than 3500 gallons capacity must be insured for $1

million if operated in interstate commerce. Section 30 also requires that the insurance cover not only personal injury and property damage but include coverage for "environmental restoration", a term left undefined in the statute.

Today, one year after implementation, the full effect of Section 30 is now being felt. Due to adverse court decisions, insurance companies are routinely excluding environmental restoration from such policies. Companies who a year ago were carrying as much as $20 million insurance are now finding it difficult, if not impossible, to even obtain $5 million. And the premiums are staggering.

SMALL BUSINESSES BEING FORCED OUT

In testimony before the Senate Small Business Committee, one small marketer from Oklahoma, Mr. Kenneth Green, noted that his insurance premiums went from $113,000 to $250,000, while his coverage dropped from $6 million to $5 million. Another company, Jubilee Gas Company, Inc. of Selma, Alabama, found it so difficult to obtain insurance that they decided to sell the business. Yet another business in Ohio had their excess insurance non-renewed last October despite a 30 year safety record that had won several awards from their insurer! They were able to obtain renewal only 8 hours before final cancellation. Their premiums increased from $13,000 to over $47,000. Indications are that it may exceed $100,000 next year. This company, a small, family business serving a few thousand homeowners dependent on propane for their heat, is now reviewing two bids to purchase the company instead of continuing the fight.

Enclosed are copies of some of the correspondence we have received from around the nation outlining the problems of propane gas dealers in this current crisis.

A RECOMMENDATION FOR IMMEDIATE RELIEF

Two immediate, alternative solutions would help propane gas dealers: (1) either repeal the $5 million statutorily-set financial responsibility requirements of Section 30 of the Motor Carrier Act of 1980; or, (2) amend Section 30 to delete the specified amount of insurance and vest in the Department of Transportation, Federal Highway Administration, authority to set appropriate levels of financial responsibility through rulemaking. We recommend either of these solutions because the safety record of this industry simply does not justify federally-established

minimum levels of insurance, nor has any documented evidence ever been put forth to prove that $5 million ought to be the minimum level of insurance.

Until 1980, insurance levels for propane gas retailers and transporters were essentially the province of state regulatory authorities who handled the matter adequately. Section 30 was added in response to demands from the common carrier trucking industry for protection against new entries into the business who might not have the financial resources to maintain a viable enterprise. We support all efforts targeted at maintaining a high level of safety in over-the-road operations; however, we cannot agree that safety can be guaranteed by simply mandating certain minimum levels of financial responsibility.

The insurance industry testified in 1980 that they cannot be considered "policemen" who keep unsafe operators off the highways. The fact that a company has $5 million insurance merely indicates that they are able to afford the insurance and that there is sufficient underwriting capacity in the marketplace: it is not a guarantee of safe operations. In many states, assigned risk pools have been established by state law so that even if a company cannot obtain insurance through the regular market, they often can obtain it through assigned risk pools (although even this mechanism has broken down in this current crisis due to lack of capacity and the refusal of insurance companies to write policies covering "environmental restoration"). Therefore, it is misleading and inaccurate to claim that minimum levels of financial responsibility ensure safety. It simply is not true.

At its most recent meeting on January 31, 1986, the National Motor Carrier Advisory Committee, a federal advisory committee established by the Administrator of the Federal Highway Administration and the Secretary of Transportation, adopted a resolution calling on Congress to re-examine the provisions of Section 30 of the Motor Carrier Act of 1980 particularly with respect to the appropriate levels of insurance. A copy of that Resolution and a list of Committee members are also enclosed.

Finally, we have enclosed a copy of a letter submitted to the Senate Commerce Committee on September 14, 1984, as part of that Committee's oversight of Section 30 of the Motor Carrier Act. In this letter, we reported the results of an accident and insurance survey we conducted of our members in February 1984. Two years ago - fully one year

before the current insurance crunch hit American businesses - our survey revealed:

- an enviable industry safety record which belied any alleged need for federally-mandated insurance;

- anticipated cost increases that would be staggering, even in normal times, with no corresponding benefits; and,

- a potential for actually reducing the level of operating safety by diverting scarce dollars from training, education and equipment maintenance and purchase in order to cover higher premiums.

The Federal Highway Administration's (FHwA) own statistics, as reported on page 5 of the enclosed letter to Senator Packwood, corroborate our survey findings. FHwA analyses revealed that only 6 of 32,393 accidents - two one-hundredths of one percent or a risk of 105 in a million - had aggregate societal costs in excess of $500,000. In short, there is no logical, rational justification for $5 million financial responsibility levels.

In conclusion, although we believe Section 30 to be unjustified and in need of repeal, we can support an amendment which would remove the $5 million mandate and, instead, vest in the FHwA authority to establish appropriate levels of financial responsibility through rulemaking because:

(1) it would permit a rational, deliberate rulemaking process, devoid of politics, emotion and hyperbole, which would allow for a thorough analysis of the costs and benefits of mandated insurance; and,

(2) in times of crisis such as we are now experiencing, the agency would have the flexibility to permit continued operation without the required - but temporarily unobtainable - insurance now mandated by law.

TORT REFORM

Another, more long term solution to the insurance crisis is through fundamental tort reform. Legislation has recently been introduced in the Senate in the form of S. 2046 by Senator Mitch McConnell (R-KY) entitled The Litigation Abuse Reform Act of 1986. The provisions of S. 2046 would apply to tort actions brought in federal court and would, among other things, require periodic payments

over the estimated lifetime of an individual for damage awards in excess of $100,000; provide offsets for collateral source benefits; cap non-economic losses (e.g., pain and suffering) $100,000; limit attorney fees to a sliding scale of 35% of the first $50,000 awarded, 30% of the next $50,000, 20% of the next $100,000, and 10% of those amounts in excess of $200,000; prohibit attorney contingency fees based on punitive damages; limit the award of punitive damages to willful and wanton conduct, and mandate that such damages be paid to the U.S. Treasury, not to the plaintiff; and, penalize attorneys for bringing frivolous actions or suits merely with the intention of obtaining favorable settlements with no anticipation of success at law. NLPGA supports basic tort reform legislation such as S. 2046 both in the federal and state courts as essential in order to restore sanity to the U.S. civil justice system.

CONCLUSION

On behalf of the members of the propane gas industry and the National LP-Gas Association, we urge Congress to take immediate action to relieve the pressures on propane gas marketers who are unable to obtain statutorily mandated insurance at any price or at such a cost as to be economically unjustifiable. We are calling for immediate repeal of Section 30 of the Motor Carrier Act of 1980, or amendment to vest in the Department of Transportation, Federal Highway Administration, authority to establish appropriate levels of insurance.

We also call for immediate consideration of S. 2046 and similar tort reform legislation designed to restore a tort system that provides prompt, just and full compensation to injured victims at a reasonable cost without outraging common sense notions of justice.

Respectfully submitted,

Daniel N. Myers
Vice President, Government
Relations & General Counsel

DNM:pc

Enclosure

RUTHHART SMITH CORP.

Insurance - Bonding

Telephone 215 - 868-5121
530 West Broad Street
P. O. Box 4085
Bethlehem, PA 18018

February 14, 1986

Mr. Daniel Myers
1235 Jefferson Davis Highway
Suite #702
Arlington, Virginia 22202

Re: Insurance Requirements and Availability

Dear Mr. Myers,

We are insurance brokers for many propane dealers who are experiencing an absolute crisis in availability and pricing in the insurance market place. The demise of the propane industry and general safety and rights of innocent third party victims could be imminent if corrective action is not taken at once. The reinsurance market place is causing huge price increases which are causing some dealers to go bare without insurance. We have seen many cases of 300 o/o increases, $1 million layers of liability costing $12,000 per $1 million, $50,000 minimum premiums etc. It would seem that the government should be pressured into dropping requirements from $5,000,000 to $2 million. The availibility is just not within reason. Our legislators have to be made aware since energy is in the public safety"s best interest. Insurance is regulated by states but federal mandates require $5 million coverage.

We are members of your association and now before it is too late, I urge you to take action. I would even suggest your national advertising to alert the consumers to be aware of this problem. Propane dealers going out of business will create a fixed price for the consumer who will not have a place to shop for energy. The glut of fuel is polarized by the cost of insurance. They do not go hand in hand. I would appreciate your comments.

Sincerely,

William F. Ihrie, Jr.

William F. Ihrie, Jr. CPCU
President

cc: Mr. Robert Nicholson
Mr. Brian Clayton
Mr. Thomas Lopatofsky

YOUR Independent Insurance AGENT

JUBILEE GAS COMPANY, INC.

Propane Gas Service
Gas Appliances
LP Gas Carburetion

Highway 80 West
Selma, Alabama 36701
Phone 874-6574

P.O. Box 94
Maplesville, Alabama 36750
Phone 366-2555

2-28-86

DEAR DON

FOR SOME OF US THE HASSLE BECAME TOO GREAT.

I TALKED WITH YOU IN NOV.-MAYBE OCT. 85 - WHEN THE MOTOR CARRIERS ACT OF 1980 WAS BROUGHT TO MY ATTENTION AND DIXIE PIPELINE WAS REQUIRING ~~THE~~ FIVE MILLION LIABILITY COVERAGE TO ENTER THEIR TERMINALS.

IN DECEMBER I SOLD MY BUSINESS TO BLOSSMAN GAS INC. I WANTED YOU TO KNOW THAT PART OF MY DECISION TO GET OUT OF THE BUSINESS WAS BASED ON THE UNFAIR (I THINK) PROVISIONS OF THE 1980 MOTOR CARRIERS ACT.

CARRY ON THE FIGHT.

Harold D. Gregg, Pres.
Jubilee Gas Co. Inc

ALBUQUERQUE HIGHWAY

LP-GAS SERVICE

PHONES 471-2883
471-2884

COTTON BUTANE CO., INC.

P.O. BOX 407
SANTA FE, NEW MEXICO 87502

February 17, 1986

Daniel N. Myers
National LP-Gas Association
1235 Jefferson Davis Highway
Arlington, VA 22202

Dear Mr. Myers:

As an independent LP Gas dealer and gasoline distributor, we have been hit hard with outrageous increases in our annual Comprehensive General Liability premiums. This national liability insurance crisis, and it is a crisis, is forcing many businesses to close down all together. And if our premiums continue to skyrocket in 1987 as they have in 1985 and 1986, it is very likely that we will be forced to close our doors also.

In 1984 our annual premium was $43,476. In 1985 we were slapped with a $74,681 annual premium; up 72% but the least of three or four bids. Three weeks ago we were presented with our one and only bid for 1986 from Ranger Insurance Co., and the total was $170,213; up a whopping 128% over last year, and a staggering 292% over the last two years !!! When will this monstrosity end ?

Much of the increase is due to Section 30 of the 1980 Motor Carrier Act. This law requires $5 million in liability insurance for trucks that transport various hazardous materials. In Ranger's proposal, the Comprehensive General Liability premiums at the $1 million level totaled $105,113 , the $3 million level rose to $122,213 , and to get a $5 million limit it will cost us $170,213. The additional $2 million excess layer from $3 million to $5 million cost $48,000 , which is more than our total premium was in 1984.

In short, we need relief NOW! The major LP Gas companies that operate all over the country have the advantage of a large menu to choose from, and the insurance companies are forced to offer competitive rates. Small independents are limited to those insurance companies that have a license to offer coverage within the state.

ALBUQUERQUE HIGHWAY

U-GAS SERVICE

PHONES 471-2663
471-2664

COTTON BUTANE CO., INC.

P.O. BOX 4037
SANTA FE, NEW MEXICO 87502

For the sake of all business, but especially for small independents, please take the necessary steps to encourage Congress to amend or relax the provisions of Section 30 of the 1980 Motor Carrier Act and impress upon Congress the seriousness of this crisis. The problems from Worker's Compensation in New Mexico have had a strong effect on us, but that compounded by the $5 million limit in liability is simply overwhelming our company.

We would greatly appreciate any effort you could give to help rescind Section 30 of the 1980 Motor Carrier Act and update New Mexico's Worker's Compensation program. Enclosed is a bar graph illustrating what has happened, and what could happen, to our liability premiums.

Thank you for your time and consideration.

Sincerely,

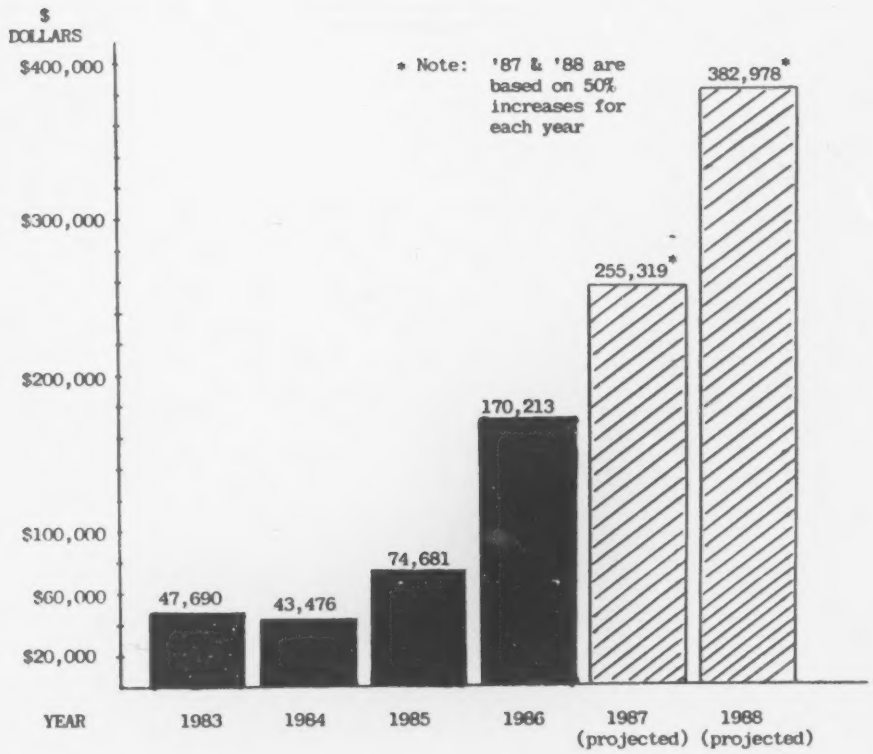
Gary B. Cotton

Gary B. Cotton, Vice President

GBC/id
Enclosure

COMPREHENSIVE GENERAL LIABILILY

ANNUAL PREMIUMS



NEWPORT COUNTY BOTTLED GAS CO., INC.

Suburban Propane

50 Underwood Lane
Middletown, Rhode Island 02840
(401) 847-6878

March 4, 1986

The Honorable John H. Chafee
U.S. Senate
Washington, D.C. 20510

Dear Senator Chafee:

As you know, there exists a major problem in the country today for many industries to obtain liability insurance, at any cost.

We are a small family owned propane dealership, and have found it impossible, (through no fault of our own) to get any insurance company to renew our general liability policy.

Apparently huge court settlements being awarded to accident victims have made propane dealers and distributors "Untouchable" in the eyes of insurance companies and their brokers.

We have run our business successfully for over 25 years, and have always had insurance. Now we feel uncomfortable operating without it.

We respectfully request your help in finding a solution to this problem, and thank you for your attention to this matter.

Very truly yours,

David A. Sherman

David A. Sherman
President

Sands
PROPANE, INC.

February 25, 1986

Congressman Jim Wright
1236 Longworth House Office Building
Washington, D. C. 20515

Dear Congressman Wright:

The Motor Carrier Act of 1980 placed on members of our industry a requirement to carry at least $5 million in liability insurance. The liquified petroleum gas industry, at the time, opposed the requirement because of its excellent safety record, but the law was enacted, nevertheless.

Now, with the present liability crunch affecting our country, many propane dealers throughout Texas, and the United States, are unable to fulfill the insurance requirement of the law (please see the enclosed non-renewal notice received by our office.)

If I am unable to find the required insurance I know of at least 3,000 families in North Central Texas that will be without fuel. I urge you to contact the Federal Highway Administration and/or DOT in an effort to relax these requirements so that we may continue to supply the needs of this country with a very important energy source.

The National L P Gas Association's office in Washington (703-979-3563) can supply you with pertinent data regarding this very serious problem to the rural dwellers of this country.

Thank you.

Yours truly

Mike Sands

P. O. DRAWER J • WEATHERFORD, TEXAS 76086 • 817-594-3808

NOTICE OF CANCELLATION OR NONRENEWAL

OF Commercial Umbrella Liability
(KIND OF POLICY)

POLICY NO.	ISSUED THROUGH AGENCY OR OFFICE AT	CANCELLATION OR TERMINATION WILL TAKE EFFECT AT: (DATE) (HOUR—STANDARD TIME)	DATE OF NOTICE
RU 417964	Weatherford, Texas	April 01, 1986 12:01 A.M.	2-7-86 sb

INSURANCE COMPANY: Ranger Insurance Co.

NAME AND ADDRESS OF INSURED: Sands Propane, Inc.
P.O. Drawer J.
Weatherford, Texas 76080

(Applicable item marked ☒)

CANCELLATION
☐ You are hereby notified in accordance with the terms and conditions of the above mentioned policy that your insurance will cease at and from the hour and date mentioned above.
If the premium has been paid, premium adjustment will be made as soon as practicable after cancellation becomes effective.
If the premium has not been paid, a bill for the premium earned to the time of cancellation will be forwarded in due course.

☐ You are hereby notified in accordance with the terms and conditions of the above mentioned policy that your insurance will cease at and from the hour and date mentioned above due to nonpayment of premium.
A bill for the premium earned to the time of cancellation will be forwarded in due course.

NON RENEWAL
☒ You are hereby notified in accordance with the terms and conditions of the above mentioned policy that the above mentioned policy will expire effective at and from the hour and date mentioned above and the policy will NOT be renewed. Company no longer provides coverage

IMPORTANT NOTICE
☐ In compliance with the Fair Credit Reporting Act (Public Law 91-508), you are hereby informed that the action taken above is being taken wholly or partly because of information contained in a consumer report from the following consumer reporting agency:

(NAME)

(ADDRESS)

GU 0811b (Ed 3-73) © 1983

INSURED'S COPY

Mike Mahoney
Authorized Representative
Mike Mahoney

NATIONAL LP-GAS ASSOCIATION

1235 JEFFERSON DAVIS HWY., STE 702 NLPGA ARLINGTON, VIRGINIA 22202

DANIEL N. MYERS
VICE PRESIDENT GOVERNMENT RELATIONS
& GENERAL COUNSEL

Phone 703/979-3563

September 14, 1984
File: 285.41/84-11

The Honorable Bob Packwood
Chairman
Committee on Commerce, Science and
Transportation
United States Senate
Washington, D.C. 20510

Dear Senator Packwood:

The National LP-Gas Association (NLPGA) offers the following comments on Section 30 of the Motor Carrier Act of 1980 and requests that they be incorporated into the record of the oversight hearing scheduled by your Committee for September 18, 1984.

NLPGA is the national trade association of the LP-gas (principally propane) industry with a membership of about 4100 including 47 affiliated state and regional LP-gas associations representing all 50 states. NLPGA represents all segments of the propane industry including producers, transporters, wholesalers and retailers of propane gas, as well as the manufacturers and distributors of associated equipment and appliances. Our members own over 25,000 transport and delivery trucks operating in both interstate and intrastate commerce, in private and for-hire carriage. Over 93% of the propane shipped in the United States travels by tank truck at one time or another.

NLPGA has consistently registered its opposition to Section 30 of the Motor Carrier Act of 1980, a provision adopted without benefit of hearings or any documented evidence of need. If Congress believes there is merit in mandatory minimum levels of financial responsibility, then we suggest and support amendment to Section 30 to grant discretionary authority to the Secretary of Transportation to establish the appropriate levels. Such discretionary authority would provide an opportunity to establish limits based on a record of proven need with flexibility to adjust limits as needs change.

CONGRESS WAS SOLD A BILL OF GOODS

Quite frankly, Congress was sold a bill of goods in 1980. Congress was told that deregulation would open the door for any huckster to enter the trucking industry and make a quick profit with little or no concern for truck safety. Images of outmoded and unsafe rigs; of unskilled, illiterate and poorly trained drivers; and of callous, money-hungry entrepreneurs were portrayed against a montage of past trucking accidents. Congress was told that the best way to prevent this was to mandate a certain minimum level of financial responsibility: only the safe operators could get insurance and the "bad actors" would be forced off the road by the insurance companies. Nothing could be further from the truth.

Due to a residual market mechanism, any trucker denied coverage by three insurance companies and who has a valid driver's license can obtain insurance. The American Insurance Association has repeatedly testified that insurance is available to all, no matter what their safety record may be, through assigned risk pools; that there is no correlation between enhanced safety and levels of insurance; that the insurance industry does not wish to nor can it act as surrogate regulators of the motor carrier industry; and, that safety may even be compromised as scarce financial resources are diverted from truck maintenance and driver education to pay higher insurance premiums.

NLPGA SURVEY

In an effort to document this latter point - that money previously spent on truck safety may be diverted to cover the higher premiums resulting from Congressionally-mandated minimum levels of financial responsibility - in February 1984, NLPGA surveyed its smaller marketer members, those with annual sales of propane under 2 million gallons. The purpose of the survey was to obtain statistical data on truck operations, safety and insurance levels. Responses to the questionnaire were received from 720 companies, 27% of the 2672 companies surveyed.

The survey was limited to the smaller propane marketers for two reasons: first, smaller companies are less likely to carry the statutory level of insurance required by the Motor Carrier Act of 1980; and, second, the cost of insurance, safety training, driver education and truck maintenance typically represents, percentage wise, a larger budget item for small companies than large companies. As a result, we believe this report shows a conservative picture of the propane industry: figures for safety-related expenditures have not been inflated by a few high-budget companies.

The 720 respondents averaged 25 years in the propane business.

A total of 54.5 million miles per year of hazardous materials transportation is represented, or 75,500 miles per company. The total number of trucks owned by the respondents is 219 "bulk" trucks (over 3500 gallons water capacity) and 2090 bobtails (trucks exceeding 10,000 pounds gross vehicle weight rating (gvwr), but under 3500 gallons w.c.). The statute exempts vehicles under 10,000 pounds gvwr. The average number of trucks per respondent is 3.2 delivering an average one million gallons annually. The total annual sales represented by the survey is three-quarters of a billion gallons to approximately 1 million customers.

Industry Safety Expenditures

One aspect of the survey attempted to ascertain the small propane marketer's commitment to safety. Thus, respondents were asked how much is budgeted for truck maintenance and purchases, driver training, and safety training. The respondents reported an average annual budget for truck purchases of $16,800; truck maintenance, $16,200; driver training, $1,100; and, safety training, $850. The current average annual cost of insurance for respondents is $10,500. This cost will increase markedly when the Congressionally-mandated minimum levels of financial responsibility are fully implemented on January 1, 1985.

For example, companies operating bobtails are currently required to demonstrate $500,000 minimum financial responsibility An increase to $1,000,000 as required by the Act will mean an additional $2165 in premiums, per company: an increase of 20%. Bulk vehicles (transports) must now be insured for $1,000,000; an increase to $5,000,000 will increase premium costs by an average of $3066 per company,or 30%.

How Will Industry Cover Cost Increases?

Cost increases of 20% to 30% are not insignificant and cannot merely be absorbed. The natural reaction may be to assume that these expenditures will be merely another cost of doing business and will be passed on to the customer; unfortunately for the small businessman, various factors militate against a mere passthrough. Thus, for example, competition, the general state of the economy, and other overhead cost increases will work to deter an automatic price increase to cover each new cost.

We wanted to find out what would be the response of marketers facing a cost increase of this magnitude. Thus, we asked the following question:

> "Assuming you are required to increase your insurance premiums to reach the statutory levels, in what portion(s) of your operations, if any, would you be forced to reduce expenditures?"

Since we did not suggest categories where expenditures might be reduced, we had a variety of answers. The following were the most frequent responses, listed by the percentage of responses:

1. Reduce truck purchases - 25%.

2. Reduce truck maintenance - 12%.

3. Reduce driver training - 10.5%.

4. Reduce safety training - 9.3%.

5. Increase price of product - 7.5%.

These figures clearly indicate that Congressionally mandated higher levels of insurance may have an adverse impact on safety in the propane industry. Thus, for example, 37% of the respondents will divert money from equipment purchase and maintenance to buy more insurance. Another 19.8% will reduce training programs to pay for this Congressionally required insurance. Out of 720 small propane marketers serving a million customers annually and traveling 54.5 million miles, 409 will begin operating increasingly older and less well-maintained trucks with poorer trained drivers, all in the name of safety!

This belies the concept behind Section 30 of the Motor Carrier Act of 1980 that higher insurance increases safety. By analogy we can compare this to life insurance. Is a person who is insured for $50,000 less apt to die than a person insured for $1,000,000? Insurance has no bearing on the question. What, however, if the one insured for $1,000,000 cannot afford preventive maintenance (annual physicals) because they spend their available funds on insurance premiums? At this point the insurance may make their life less safe than that of the person who carries less insurance and gets annual physicals (preventive maintenance).

Small Marketer Accident History

Traveling an average of 54.5 million miles per year, the 720 respondents have had accidents. These marketers reported a total of 1000 accidents in which their trucks have been involved over the past 10 years. Of these 1000 reported accidents, 300 resulted in the payment of a judgment, settlement or paid claim. Of these 300 judgments, settlements or paid claims, 282 or 94% amounted to no more than $50,000. Indeed, 225 or 75% were under $5,000!

Since Congress focused on members of the hazardous materials industry - and liquefied gas carriers in particular - for special treatment, it is important to zero in on those accidents where

there was a release of product. After all, one of the most frequently reported forms of accident was trucks hitting low-hanging tree limbs: hardly a threat to society. Our survey asked for the total number of accidents ever (not confined to the past 10 years) in which product was released. The answer was 17. Of those seventeen, in only 6 did the release of the product contribute to damages. Of those 6, one resulted in $4000 damages, one caused $3000 in damages, one was covered by workman's compensation, one is not yet settled, and the sixth resulted in no damages.

Congress Must Wake Up

We believe our survey tells a clear story:

(1) the accident history of the propane industry demonstrates neither a tendency toward sloppy handling nor a record of repeated catastrophic incidents and uncompensated victims;

(2) the added costs to industry will be substantial and, again, are not offset by any corresponding benefits; and,

(3) the net result may be an actual reduction in the level of operating safety in order to cover the higher premium costs.

The American Insurance Association submitted corroborating data to the Federal Highway Administration obtained from the Insurance Service Office (ISO), the statistical agent representing 75% of the total commercial automobile market. The ISO data, reported in the July 2, 1984, Federal Register, page 27290, reflect commercial autombile losses (including public autos, garage vehicles and trucks) incurred from January 1, 1977, through September 30, 1981. There were 1,908,861 paid losses, 839 of which were settled for between $250,000 and $500,000. Only 157 losses were settled for over $500,000. That amounts to one-one hundredths of one percent!

In that same Federal Register notice which was the extension of the lower phase-in levels of the financial responsibility rules through the end of 1984, the Federal Highway Administration (FHwA) published their own statistical findings. They analyzed 32,393 accidents reported in 1982 to determine their "societal costs", an aggregate of their fatalities, injuries and value of property damage. The FHwA analyses revealed that only 6 of 32,393 accidents (two one-hundredths of one percent or a risk of 105 in a million) had aggregate societal costs in excess of $500,000. In 1982, only three accidents were reported with property damage equal to or greater than $1 million: in these three accidents, the average societal costs amounted to $1.4 million.

CONCLUSION

NLPGA urges the Senate Commerce Committee to begin work immediately to either rescind Section 30 in its entirety or to enact legislative recommendations offered by the U.S. Department of Transportation which would permit the establishment of appropriate financial responsibility levels by DOT where a need for such levels is clearly demonstrated and at an amount which will not be injurious to small business.

Respectfully submitted,

Daniel N. Myers
Vice President, Government
Relations & General Counsel

DNM:pc

National LP-Gas Association • 1301 West 22nd Street • Oak Brook, Illinois 60521 • 312-986-4800

URGENT

The following survey data are urgently needed to help NLPGA work on amendments to the Motor Carrier Act financial responsibility requirements. The survey is anonymous. If you do not have precise answers, a best estimate is better than no answer. Please respond by February 29, 1984. Thank you.

1. How many years have you been in business? _____
2. How many gallons of propane do you sell annually? _____
3. Approximately how many miles do your trucks travel annually? _____
4. How many customers are serviced by truck delivery? _____
5. How many trucks over 3500 gal. w.c. do you operate? _____
6. How many trucks over 10,00 lb. gvwr and less than 3500 gal. w.c. do you operate? _____
7. Do any of the trucks in question 6 cross state lines? _____
8. How much do you spend or budget annual for:
   a truck maintenance _____
   b truck purchases _____
   c driver training _____
   d safety training _____
   e vehicle insurance _____
9. What are your current insurance limits? _____

Estimated Average Cost of Minimum Liability Insurance

Limit	High Rate Arlington, VA	Average Rate Omaha, NE	Low Rate Dayton, OH
25,000 CSL	$2,063	$1,680	$1,343
100/300/50	3,402	2,784	2,215
Additional Charges for:			
500,000 CSL	$ 394	$ 322	$ 256
750,000 CSL	600	491	390
1,000,000 CSL	786	643	511
5,000,000 CSL	2,003	1,638	1,304

10. Based upon your insurance agent's estimate or the above table choosing the city most like your area if necessary, how much would your annual premiums increase if you had to carry 1 million dollars for all trucks under 3500 gal. and 5 million dollars for all trucks over 3500 gal. _____
11. Assuming you are required to increase your insurance premiums to the amount in question 10, in what portion(s) of your operations, if any, would you be forced to reduce expenditures? _____
12. How many accidents involving your trucks have you had over the last 10 years? _____
13. What was the largest payment to an injured party? Truck accidents only. _____
14. List the number of judgements, settlements or claims paid from truck accidents in last 10 years by the following gategories:

Dollar Size	Number	Dollar Size	Number
Under $5,000	____	$100,001 - 300,000	____
5001 - 50,000	____	300,001 - 1,000,000	____
50,001 - 100,000	____	1,000,001 - 5,000,000	____

15. How many of the above accidents involved loss of product. _____
16. Have you ever had a truck accident in which propane loss/spill contributed to personal and/or property damages? Yes ___ No ___
    If yes, year(s) and amount(s) of judgement or settlement. _____

PLEASE FOLD OVER, STAPLE, STAMP AND MAIL IMMEDIATELY

RESOLUTION
of the
NATIONAL MOTOR CARRIER ADVISORY COMMITTEE
to the
FEDERAL HIGHWAY ADMINISTRATION

Approved January 31, 1986

Whereas the National Motor Carrier Advisory Committee has received information and evidence that there is a "liability insurance crisis" in America today; and,

Whereas it appears to the Committee that although all businesses appear to be affected, the motor carrier industry is particularly hard hit; and,

Whereas the Committee believes that the hazardous material motor carrier industry is severely handicapped through operation of Section 30 of the Motor Carrier Act requiring up to $5 million financial responsibility to compensate for undefined "environmental restoration" and other damages; and,

Whereas the Committee believes that without change in the requirements of Section 30 some carriers of hazardous materials either may have to operate illegally or park their trucks and deny vital motor fuels, heating fuels, and other hazardous materials to their customers this winter;

Now, therefore, be it resolved that the National Motor Carrier Advisory Committee urges the Administrator of the Federal Highway Administration and the Secretary of the U.S. Department of Transportation to take such steps as necessary to encourage Congress to review the provisions of Section 30 of the 1980 Motor Carrier Act specifically including appropriate levels, categories, definitions, the concept of joint and several liability, and proofs of insurance in this time of crisis; and,

Be it further resolved that this Committee requests the Administrator of the Federal Highway Administration to transmit a copy of this Resolution to the appropriate Committees of Congress in order to impress upon them the seriousness of this crisis.

63-092 O - 86 - 7

NATIONAL MOTOR CARRIER ADVISORY COMMITTEE
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11/85

Testimony Concerning
The Cost and Availability
of Liability Insurance for Small Business
Before The
Senate Small Business Committee
February 21, 1986

My name is Ken Green and I am President of Oklahoma Liquefied Gas Company, headquartered in Seminole, Oklahoma. I am here today speaking on an issue which is having a great impact on our company as well as our business companions across the country, liability insurance. In the next few minutes I would like to share with you the nightmarish experience our company has just been through concerning this colossal insurance dilemma.

First I would like to give a little background information on our company. Oklahoma Liquefied Gas is a medium size independent propane distributor serving some 5000 residential and commercial accounts with propane gas in central Oklahoma. This propane is used mainly for home and industrial uses when natural gas is not available, however there are also other uses such as motor fuel and recreational uses. We also wholesale and truck propane gas to other dealers throughout Oklahoma. Our total yearly revenue is approximately $6,000,000.

Our insurance problems began in September of 1985 when we received a cancellation notice from the insurance carrier at that time. The cancellation was to take effect December 20, 1985, the anniversary date of the policy. At this time we were in the first year of a three year contract. However, as it turned out, only ten days notice was required to cancel this contract. The reason for this cancellation was stated as the inability to renew with the reinsurance company who was getting out of this particular market entirely.

As gloomy as it might sound, this news did not alarm us at that time. We had already began looking into coverage for 1986 and had been assured by several agencies that coverage for a company with our track record would be no problem. This track record refers to our loss ratio, losses paid to premiums earned, over the three previous years. The table below illustrates these numbers.

YEAR	PREMIUM EARNED	LOSSES & EXPENSES PAID	2 LOSS RATIO
1983	$169,243	$28,862	.171
1984	88,589	-0-	.000
1985	113,018	22,234	.197
TOTALS	$370,850	$51,096	.138

With a total of six large agencies confidently shopping nationwide and this loss ratio, we felt it would be no problem to locate adequate and affordable coverage. To us affordable meant no more than an anticipated 25 to 30 percent premium increase.

Over the next two and one half months we discovered that finding coverage, at any price, was far from easy. One by one the different agencies began to drop out unable to find coverage. It seemed a few companies had some interest in our business but could not get the reinsurance necessary to write the business until after the first of the next year, too late for us. As it turned out our renewal was coming due at the worse possible time.

On the afternoon of December 19th, the final day of the existing policy, we had decided we would close business the next day and go to the State Insurance fund for help. Fortunately for us, as it turned out, this was not necessary. Two other options came available with one being acceptable. One option came available when one of the agencies was able to secure coverage from a specialty insurance company. The shocking news was the premium for this coverage. For only 5% of the coverage we had had, $300,000 limits vs. $6,000,000 limits, we were looking at a premium of $417,000 vs. $113,018 for the previous year. This increase by the way was more than our total projected cash flow for the entire year.

The second option, which turned out to be our solution, came about when we found out the Association Insurance Company of Texas was licensed to do business in Oklahoma. This group had been doing business in Texas since 1972 with propane dealers throughout the State. They had applied to do business in Oklahoma three months earlier and just three days prior to our deadline were granted approval to do so. Anticipating this licensing, we had mailed an application just in case it came through in time to help us. Just six hours before our coverage terminated we were bound by the Texas group.

At this time we had no idea what our premiums would be, but felt sure they would be much less than the $417,000 quote and would give us adequate coverage. Just recently we received our final premium figures. With one million less coverage, $5,000,000 vs. $6,000,000 and higher deductibles, our premiums increased to $250,000 compared to the $113,018 for 1985.

Now that we have the coverage, we have begun the process of figuring out how we can pay the premiums. The insurance problem coupled with the existing economic depression in our state has caused us to go back to the drawing board on our 1986 budget. We have already eliminated nearly 25 per cent of our work force, ten employees in the last 45 days. We have plans to park some of our equipment, remove insurance, and attempt to liquidate it. In some cases the new insurance premiums actually make some equipment too costly to operate. This is especially true of the equipment which we are required by Section 30 of the Motor Carrier Act of 1980 to carry $5,000,000 of insurance coverage on.

As we communicate with other propane dealers across the country we find they too are experiencing similar crisis concerning their liability insurance. One dealer in Kansas has received a preliminary quote of over $700,000 for his new coverage compared to $200,000 for his existing coverage. Others are finding adequate coverage nearly impossible to locate. In Oklahoma, dealers view the insurance crisis as having a similar negative impact as the current depressed oil prices.

We feel the Federal Government can assist propane dealers like ourselves immediately by reducing the $5,000,000 insurance limit required by Section 30 of the Motor Carrier Act of 1980 to $1,000,000. We have in recent years carried in excess of $5,000,000 of coverage and were doing so before it was law. However, we feel the cost and/or availibility will make this law virtually impossible to comply with.

This is only a partial answer to the problem and only effects a certain segment of our industry. We feel as do other businessmen we have conversed with, that the long term solution is to control insurance rates through a more judicious handling of settlements with a move towards a fair and reasonable limitation of liability lawsuits.

This concludes my testimony and I'll be happy to answer questions.

Appendix C.—Additional Information From the Small Business Service Bureau

SBSB LIABILITY INSURANCE SURVEY RESULTS
March 14, 1986

---

1) HAVE YOU BEEN ABLE TO OBTAIN/RENEW LIABILITY INSURANCE?

Yes:	90.1%
No:	9.9%

---

2) BY HOW MUCH HAVE YOUR PREMIUMS INCREASED?

a) Not At All:	5.5%
b) 1 - 10%:	11.9%
c) 11 - 50%:	30.1%
d) 51 - 100%:	21.8%
e) 101 - 500%:	25.6%
f) More Than 500%:	5.1%

---

3) WHAT TYPES OF LIABILITY COVERAGE PRESENT PROBLEMS TO YOU?

a) General:	40.6%
b) Environmental:	3.9%
c) Professional:	17.6%
d) Malpractice:	10.0%
e) Transportation:	7.3%
f) Officers/Director:	2.7%
g) Product:	12.1%
h) Liquor:	5.7%

---

4) WHAT ALTERNATIVES, IF ANY, ARE YOU PURSUING?

a) Dropping Products/Services

4.4%

b) Self-Insurance:

7.5%

c) Paying Higher Premiums/Raising Prices:

45.6%

d) Closing your business:

10.5%

e) Going without coverage:

25.3%

f) Other (Please Specify)

6.7%

4f) Comments:

"Less liability and comp. coverage."

"Taking out assets, setting up shell corp."

"Absorbing cost increase."

"Selling business."

"Cut my business by 75%"

"Find a new [insurance] company."

"Cutting back [coverage]."

"Paying higher premiums and absorbing costs."

"Greatly reducing coverage."

"Selling part of business."

"Losing clients."

"Carry minimum coverage."

"Must absorb cost."

"Co-op coverage."

"Diminished profits."

4f) Comments (continued)

"Less coverage."

"Reduce coverage."

"Reducing coverage & maximum limits."

"Paying higher premiums, but absorbing costs to stay competitive."

---

5) WHAT DO YOU FEEL IS THE REASON FOR THE INCREASE IN THE NUMBER OF LIABILITY SUITS AND DAMAGE AWARDS?

a) Professional/Business communities are less competent:

2.0%

b) Legal system encourages frivolous claims:

48.0%

c) Liability is based on ability to pay, not wrongdoing:

26.2%

d) Consumers have unrealistic expectations:

19.1%

e) Other:

4.6%

5e) Comments:

"Too many lawyers trying to make a living."

"Greed"

"Insurance rip-off also."

"Insurance industry/judicial view."

"Professionals don't weed out bad apples."

"Insurance Co.s willingness to settle."

"Fly-by-night contractors."

"Legal fees."

"Sue-happy people."

"Insurance industry mismanagement."

"Consumers are more aware, less likely to take crap."

" Consumer education."

5e) Comments (continued)

"Insurance co.s pay too easiliy."

"Greedy lawyers."

"Greed."

"I don't know."

"Lack of quality control."

"Combo of sue-happy customers and too many hungry lawyers."

"People are no longer responsible for their actions, it is always someone else's fault."

"Politicking to put ceiling on awards."

"Too many lawyers and short-sightedness of insurance industry."

"We have become a sue-happy society."

"Legal fees based on % of award encourages prospecting by lawyers."

"I think the insurance companies are having a field day."

"Sloppy management, careless employees."

---

6) WHAT IS YOUR BUSINESS OR PROFESSION?

Service	28.6%
Contractor	11.1%
Sales	10.7%
Finance/Real Estate	9.2%
Health Care	7.4%
Manufacturing	6.8%
Retail	5.5%
Restaurant/Tavern	4.3%
Professional	3.7%
Recreation	3.1%
Transportation	2.2%
Other	2.2%
Distributor	
Wholesale	
Non-Profit	
Lawyer	

7) WHICH OF THE FOLLOWING APPROACHES TO THIS PROBLEM DO YOU WNAT SBSB TO PURSUE?

a) Civil justice reform:

9.6%

b) Federal product liability reform:

5.0%

c) Limits on lawyers fees:

13.9%

d) Limits on punitive damages:

18.3%

e) All of the above:

48.0%

f) Other (Please specify):

5.2%

7e) Comments:

"Make loser pay for all legal fees/court costs."

"Industry should police itself."

"Premium could be based on claims filed against the company."

"Base premiums on claims history."

"Public advocacy for change."

"Regulation of the insurance companies."

"Have insurance companies subject to anti-trust laws."

"Keep unqualified people from going into business."

"Investigate insurance companies."

"Insurance industry discipline"

"Review policies of insurers."

"Federal regulation of insurance companies."

7e) Comments (continued)

"Plaintiffs should be required to pay for legal services rather than allowing lawyers to collect a fixed % of the amount awarded."

"Limits on pain and suffering."

"Change of consumer attitudes."

"Don't know."

"Limits on insurance company's profits."

In our business, [construction] I believe rates should be based on personal business practice."

---

8) DO YOU FEEL AWARDS IN LIABILITY CASES ARE:

a) Excessive:	95.0%
b) About Right:	5.0%
c) Too low	0%

---

9) HAVE YOU HAD ANY LIABILITY CLAIMS FILED AGAINST YOUR BUSINESS?

Yes:	14.5%
No:	85.5%

---

10) HAVE YOU CONTACTED YOUR STATE INSURANCE COMMISSIONER OR REPRESENTATIVE ABOUT THIS ISSUE?

Yes:	21.0%
No:	79.0%

GENERAL COMMENTS OF RESPONDENTS

"A feast for lawyers." (Machinery Manufacturer, MA)

"Would like to support Senator Hatch's bill regarding professional malpractice." (Physician, NY)

"There will be a reaction to the control by liability insurance companies in private sector by government intervention." (Private Physician, OH)

"Impeach judges, horsewhip the lawyers. The legislators are mostly lawyers who as a class benefit from liability litigation." (Electrical Sales Engineer, OH)

"Please get good and sensitive laws passed. We need small business." (Retail Gas/Grocery, NY)

"The judicial system is outrageous. Don't they realize that lawyers never lose out anyhow, why make them even fatter?" (Construction, NY)

"There must be a ceiling put on claims - malpractice, errors and ommissions, & product liability." (Insurance Sales, NC)

"It is not fair for a small business to be at the mercy of the insurance companies. Must be corrected." (Elevator Maintenance/Repair, MA)

"In my business [heating contractor] customers have homeowner's insurance, so any liability I carry is double coverage." (Heating Contractor, NH)

"Our insurance costs are undermining the small business people." (Awning Mfr., MA)

"Waste of time to fight a [Insurance] Commission on the insurance payroll!" (Commercial Artist, CT)

"We are at the mercy of the insurance lobby! In any business we are required by LAW to have auto insurance and there seems to be no ceiling as to how high the insurance companies are going to go!" (Driving School, CT)

"Bonding is becoming very difficult to obtain." (Roofing Contractor, MA)

"Massachusetts businesses pay national rates despite no punitive damages in Mass. Insurance companies seem to collude to set rates. State regulation is obviously poor because insurance companies are very wealthy and also give a good return on their stock." (Lawyer, MA)

"Not fair to small restaurant business." (CT)

"The lawyers and the courts (run by lawyers) have a total lack of knowledge concerning most business practices and any technical products, etc." (Mfr of Cosmetic Fragrances, CT)

Comments (continued):

"I think insurance companies should give lower premiums to those of us who seldom or never have claims. Not just one time, either, every year until we pay very small amounts. Also follow up with good advertisements of these premium reductions and a program like this should snowball fast. Sounds simple but it is better than more laws and restrictions." (Roofing Contractor, NY)

"I think the insurance companies should be regulated in some way like the public utilities." (Crane Rental, CT)

"Insurance price increases are driving small business owner in construction out of business." (NY)

"The White House Conference on Small Business may be the best group to change public policy in this matter." (General Practitioner, PA)

"Civil suits have turned into a lottery (get rich quick). Lawyers seem to encourage suits. The profession is becoming a free-for-all grab bag of slick advertising and sales pressure to encourage suits. Perhaps a cap on amounts would lessen the greed incentive." (Coin-Operated Laundry, NY)

"If something is not done soon a lot of small businesses will not be able to continue in operation." .(Retail Liquor store, CT)

"Only one company after a 6 month search would carry us." (Heating Equipment Mfr., MA)

"Insurance companies should have their rates regulated by the federal government." (Auto Repair, CT)

"Equal protection under the law should extend to the seller as well as the buyer." (Drapery/Upholstery Mfr., NC)

"Wrote to state Congressman." (General Surgeon, CT)

"As a tavern owner, I pay $1,100 for $100,000 worth of insurance. That is the maximum I can obtain. It will put us all out of business." (NY)

"We install and service petroleum equipment - pumps and underground tanks - our coverage for pollution was cancelled 10/1/85 after 26 years - no claims - unable to renew." (NY)

"Public awareness of frivolous claims that are made where the only ones that receive any funds are attorneys and court system." (Insurance Agency, NY)

"Lobbying against the insurance companies to lower or adjust premiums." (Financial Planner, MA)

"Fire and liability at the store has not gone up but product liability is out of reach." (Marine Service/Sales, NY)

"Dalcon shield case is best example, other companies will close i.e., asbestos industry, auto makers and more if we don't cut this out NOW!" (Commercial Photographer, CA)

Comments (continued)

[Writing Insurance Commissioner/Legislator] "Waste of time." (Engineer, VA)

"A simple solution to many cases would be to do away with lawyer's contingency fees." (Mfr.'s Rep., CT)

"Too much blame is put on the establishments - more emphasis should be put on people driving and drinking at same time not drinking then driving." (Social Club, NH)

"Would be interested in auto insurance from your association." (Limousine Service, CT)

"Something has to be done to get lawyers not to get paid % of settlement!" (Dentist, NH)

"My rates are all out of proportion to my one claim. I was cancelled and had to obtain insurance out of state (After one $500 claim)." (Roofing contractor, VT)

"It is a rip-off between lawyers and clients." (Restaraunt Owner, VT)

"Businesses that never had claims must be taken into consideration." (Health Club/Karate School, MA)

"Workman's Comp. Insurance is extremely too high due to excessive lawsuits." (Construction, MD)

"When it is no longer profitable for lawyers, claims will cease." (Medical Equipment Rental/Sales, MA)

"There is no reason for my premium increasing 60% in one year, especially in an area which is not high risk." (Commercial Cleaning Business, MA)

"Have contacted [Insurance Commisioner] and they refuse any blame for us not having proper coverage - its our responsibility." .(Beauty Salon, MA)

"The responsibility and accountability for drinking should be totally on the consumer." (Restaurant, NH)

"Insurance companies have too much power and are very intimidating to the public." (Auto Repair, IA)

"Sure! Lure me in with #1 - 9, then lay me away with #10! O.K., I will contact them." (Cleaning Service, IA)

"People should have a responsibility for their own actions." (Restaurant/Tavern, NY)

"Insurance, the single biggest headache for small business." (Air Pollution Control, CT)

"(Question #7) "All need reform, lawyer's fees most important." (Insurance Agent, MA)

Comments (continued)

"Liability insurance rates are causing many small businesses that we know (including ourselves) to consider working without insurance or not working at all." (Chimney Specialists, IA)

"Rate cycle is artificially generated by insurance industry itself." (Insurance Agent, MA)

"Our coverages renew in June and we're unsure we'll be able to secure renewals. The system has to be overhauled at once." (Amusement Ctr, NY)

"Pray for the insurance problems." (Farmer, Horse Trainer, NY)

"Not able to buy fire insurance unless we pay 300% of old policy for less coverage." (Auto Parts Rebuilder, OH)

"I feel the system encourages operating with no coverage." (Masonry Contractor, CT)

"Company put aside for their own insurance." (Sewing Machine Dealer, NC)

"People use liabilities problems as an excuse for "winning big" in court" (Antique Dealer, NH)

"[Awards] Entirely excessive in some cases and not at all or too low in others - awards are based on emotions of jury." (Insecticide Formulator/Marketer, IA)

"Its time these attorneys were set back on their heads." (Accountant, OH)

"More proof that the defendant was really negligent." (Electrical Contractor, IA)

"Boat repair - closed business; Marine survey and rental apartments - raised prices." (Marine Service/Apt Rentals, NY)

"This problem is getting out of hand. Quick inquiry by professionals is needed." (Real estate/Building Co., MA)

"I can't renew my lease without buying $500,000 of liquor liability to cover my landlord." (Retail Package Store, NY)

"If liability increases too much and is hard to make selection of companies, I will drop it." (Marine Sales/Service, NY)

"Changed insurance companies and able to obtain coverage. Company with previously for 25 years without a claim increased premium from $2,000 per year to $45,000/year." (Agricultural Distributor, NH)

"Problems obtaining markets for customers for all forms of liability insurance." (Insurance Agency, NY)

"In business 22 years. Business doubled but liability insurance and Worker's Comp. took all profit! Why work?" (Electrical contractor, NH)

Comments (continued)

"NC State Insurance Commission is working on this issue at present." (Day Care Ctr., NC)

"Lawyers advertising on TV with "800" numbers! It SMELLS!" (Insurance Agent, NY)

"My liability is reasonable compared to many, but it does have potential to, skyrocket." (Forester/Logger, VT)

"Something has to be done." (Day Care Ctr., NE)

"Can't afford to pau premiums!" (Grocery, IA)

"The instant 'crisis' is supported by escalating insurance premiums - where are the statistics to show that awards by juries have escalated similarly?" (Lawyer, NY)

"Thank you for your interest." (Building Contractor, NY)

"The only two liability claims I've had in four years are two broken windows. One from a rock thrown by a mower and the other a tree branch fell and broke a window. My general liability went up 85% this year alone!" (Landscaper, NY)

"People are becoming more claim-conscious - attorneys should not be allowed to work on a % of awards. (Real Estate Agent, NC)

"Do Something." (Mfr., IL)

"Because of competitive market we can't raise prices enough to compensate for cost rise." (Outdoor Advertising, NY)

"The biggest problem is that lawyers encourage claims because they have nothing to lose even when they lose." (Space Rental, CT)

"90% of small contractors do not register with state or federal government. Need better controls because of the above, our business stinks. WE pay THEY don't!" (Painting Contractor, NH)

"Limit legal profession in politics. We wouldn't vote for gangsters, would we?" (Golf Course Owner, NH)

"Utilities, Insurance and realty taxes go up faster than they can be passed on." (Convenience Store, NY)

"Make awards on a workman's Comp basis. Pre-set limits and limited legal expenses allowed. Action is imperative." (Contractor, MA)

"The insurance companies should have to pay for all the chemical dump clean-ups - not us taxpayers - why is the government cleaning up chemical companies' dumps? My insurance company raised my premium 50% because I haul oil, yet the government superfund - not the insurance company cleans up the dump - so I am paying twice - once via my insurance, second, as a taxpayer!!" (Long Haul Trucking, NH)

Comments (continued)

"My opinion of the legal profession is getting lower all the time. The guys are for the most part leeches on our society.

The civil court system should be accessible to the citizens that pay for it, without legal fees and lawyers, and most of the disputes that arise between citizens could be arbitrated through the system with little or no legal mumbo-jumbo.

We have too many damn lawyers in America and too many damn laws.

Let's encourage people to take responsibility for the choices we make. If you buy a shoddy product for too much money '<u>you are stupid</u>'. Why sue the guy that made it because he was <u>smarter</u> than you?

Marketplace factors put the guys who make shoddy over-priced goods out of business very soon." (Golf Pro, Health Club/Hair Salon Owner, NY)

"Law schools produce too many lawyers and they need cases." (Ceramic Tile Installer, NY)

"We are not heavily hit yet but it is right around the corner." (Employment Agency, NH)

"This is of great concern. It could determine the future of my business." (Computer consulting & sales, VA)

"Insurance companies are too big to fight by small business companies." (Rubbish removal co., CT)

CONNECTICUT
Trial Lawyers Association

Executive Director
Alice L. Ayers

HAVE YOU HEARD THE ONE ABOUT? . . .
HERE IS THE REST OF THE STORY

WASHINGTON, D.C., Jan. 23, 1986 -- The insurance companies, which oppose injured Americans' right to a jury trial, try to ridicule juries by parading before the media the same six or seven stories of what they call "outrageous verdicts." Some of these cases are six, seven or 10 years old and have nothing to do with truly outrageous premiums sought by the insurers today.

Nevertheless, they tell the tales to mislead the public into believing that juries give huge sums to undeserving victims and that this is driving up the cost of insurance.

Except for the victims, there is nothing horrible about these "horror stories," close examination shows. Here are the anecdotes . . . and the facts.

(more)

118 Oak Street, Hartford, Connecticut 06106 203 / 522-4345

1) The perfume and the candle.

Among those citing this case is Victor Schwartz, chief lobbyist in Washington, D.C., for corporate and insurance interests. On the network news show "Nightline," Schwartz said recently: "A woman in Maryland recovered money when perfume was poured on a lit candle."

THE FULL FACTS: First of all, Schwartz neglected to tell viewers that this case was decided 10 years ago and has nothing to do with today's issues. Second, the final award to the plaintiff was about $30,000, hardly enough to break an industry with assets of more than $267 billion. Third, the perfume was not poured on a lighted candle.

Nancy Moran, 15, was visiting a friend of the same age. There was a Christmas candle burning in a saucer. To give the candle fragrance, the friend poured cologne from a drip bottle into the saucer, not on the flame. The heat of the flame ignited the vapors rising from the cologne. The burning vapors torched the perfume in the saucer, causing it to explode into flame. Ms. Moran was seriously burned.

The jury verdict in Moran v. Faberge, Inc. was upheld in 1975 by the Maryland Court of Appeals, which ruled that the defendant knew or had reason to know that the cologne might come close enough to a flame to explode. The same product, sold in a spray bottle, contained a warning not to use it near a flame. A woman applying the cologne could experience the same result if she were to light a cigarette.

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Had the plaintiff poured the cologne directly on the flame, there would have been no case, said Martin Freeman of Bethesda, Md., who handled the case. His number is (301) 951-1610.

* * * * *

2) The refrigerator and the body-builder.

Forbes Magazine, in a July, 1985, article, syndicated columnist Ernest Conine last November, and others have cited the case of the "41-year-old body builder (who) entered a footrace with a refrigerator strapped to his back to prove his prowess. During the race, he alleged, one of the straps came loose and the man was hurt. He sued everyone in sight, including the maker of the strap. Jury award: $1 million." The quote is from Forbes.

THE FULL FACTS: The above recitation of this eight-year-old accident is wrong on several counts. In Columbo v. Trans World International, the plaintiff, Franco Columbo, was a world-champion body builder. In 1976, he won the "Mr. Olympia" contest. In 1977, he agreed to participate in a television show, "The World's Strongest Man," produced by Trans World International Corporation and aired on CBS television. The other remaining defendants were MCA, the parent company of Universal Studios, where the event occurred, and Zuver Fitness Center, Inc., the manufacturer of the equipment used by the plaintiff.

The event was to have ten participants, all well-known athletes, compete in "off-beat" contests. One event was a refrigerator race. Each contestant was to walk or run 40 yards with a 400-pound refrigerator on his back.

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Before the event, each contestant was given a written contract guaranteeing that all the equipment had been tested for safety. Zuver Fitness Center developed the contests and prepared the equipment.

Mr. Columbo was in the first of five heats. All the other contestants were more than six feet tall; Mr. Columbo is five feet, six inches tall, and all the defendants knew that fact. After he had run seven or eight yards, he fell when the rack to which the refrigerator was attached struck the ground. For someone of his height to lift the rack and refrigerator off the ground, Mr. Columbo had to bend forward deeply. This caused his center of gravity to be thrown off, and he collapsed. He suffered a total knee displacement. His injuries required extensive surgery.

At the trial, the chief engineer for Zuver admitted that 1) the equipment had never been tested by anyone Mr. Columbo's size; 2) the equipment had never been tested by anyone who had run with it; and 3) he had personally told Trans World officials that he didn't think the equipment or the race itself was safe. Other experts testified that it was not humanly possible to do what was expected in the contest. (After Mr. Columbo's fall, all subsequent contestants walked the race.)

In 1982, a Los Angeles jury awarded $1,036,760 and Trans World settled for $1 million. The company <u>was not insured</u>, so this amount had no effect on insurance premiums. And the plaintiff never alleged

(more)

that the strap broke: in fact, the maker of the strap was not sued. Attorney George Royce represented the plaintiff. (213) 552-7868.

* * * * *

3) The hot-air balloon and the laundry.

Forbes, in its July, 1985, article decrying the so-called current liability crisis, gave this example of "absurdly generous awards: Two Maryland men decided to dry their hot-air balloon in a commercial laundry dryer. The dryer exploded, injuring them. They won $885,000 in damages from American Laundry Machinery, which manufactured the dryer." This tale is repeated, virtually word for word, in many places.

THE FULL FACTS: Horan v. American Laundry Machinery Industries was decided in 1979. Mr. Horan owned a 60-foot, nylon, hot-air balloon used by his advertising agency. When it became extremely muddy, he took it to a friend in the laundry business, who advised him that his equipment was too small to launder the balloon. They then went to a local hospital, where the equipment was designed for industrial purposes, and began to launder the balloon. The laundry extractor began to vibrate violently, causing it to blow up. Mr. Horan was badly injured: his friend's hand was nearly severed, requiring microsurgery at Johns Hopkins Hospital. At the trial, it was proved that the company had a patent on a device that would have automatically stopped the machine if it vibrated excessively. This would have prevented the explosion. Nevertheless, the company

(more)

had decided before the accident not to install the device, evidence revealed.

A Baltimore jury awarded $1,260,000 to the two men. Samuel O. Jackson, Jr., now retired, represented the plaintiff. Mr. Jackson's firm's phone number is (301) 539-6633.

* * * * *

4) The horse and the Pinto.

In a speech last December, Richard Willard, assistant attorney general for the Civil Division, U.S. Department of Justice, told his audience a story repeated in many quarters:

"An Oregon jury awarded $1.5 million in damages to the estate of a women who was killed when a horse fell through the roof of her 1980 Ford Pinto. The horse had been spooked by wolves or coyotes and broke through a triple-strand, barbed-wire fence onto the highway. The horse was hit head-on by the woman's car, was knocked into the air and fell down onto the hood and roof of the car. Although Ford argued that the accident was a 'one in a million accident,' and that no car could ever withstand the impact of a horse, the jury found Ford liable."

THE FULL FACTS: In Green v. Ford Motor, Co., a Portland, Oregon, jury found Ford liable because of weakness in the design of the Pinto's roof. In 1982, Mr. Green was driving his 20-year-old wife and their newborn baby home from the hospital when a horse stepped into the road. The car hit the horse. The animal slid

across the windshield and roof. The roof collapsed. Mrs. Green was struck in the temple and killed.

The National Transportation Safety Board requires that a vehicle withstand 5,000 pounds on impact from a rollover. A rollover is analagous to what happened to the Greens' car. A simulation of the accident proved that the Pinto could withstand only 3,800 pounds. Furthermore, Ford employees testified, records of vehicles that had failed safety tests had been destroyed.

In addition, Oregon records show, a horse is involved in an automobile accident every three days. So, this is hardly a "one in a million accident." Most important, however, the car should have been able to withstand the impact of the accident. Millions of people depend on the crashworthiness of their cars.

In June, 1985, a jury brought a verdict of $1.5 million against Ford. Ford has appealed. The plaintiff's attorney is J. T. Baisch, (503) 226-3232.

* * * * *

5) The drunk driver and the phone booth.

The Wall Street Journal in a December, 1985, editorial stated the following: "A man is injured when a drunk driver crashed into a telephone booth and California Chief Justice Rose Bird rules that the company that designed the booth is liable." (Willard also has cited this case.)

THE FULL FACTS: In Bigbee v. Pacific Telephone and Telegraph Co. Chief Justice Bird, along with five of the six other justices on

the California Supreme Court, ruled in 1983 that the issue of liability in this case should be decided by a jury. A summary judgment had been granted to the defendant by the Los Angeles County Superior Court, and the Supreme Court was simply sending the case back to the lower court for trial. Bird wrote for the majority: "Where a telephone booth, which is difficult to exit, is placed 15 feet from such a thoroughfare, the risk that it might be struck by a car veering off the street, thereby causing injury to a person trapped within it, cannot be said to be unforeseeable as a matter of law."

The booth, which had been hit at least once before, was "difficult to exit," because its door was jammed, and the plaintiff was unable to flee the booth when he saw the drunk driver bearing down on him. The seventh justice, incidentally, while dissenting in part, wrote that the summary judgment was "properly reversed" on the question of the jammed door. This case, although sent back to the lower court in 1983, never went to trial. A settlement in this 1974 accident was reached, but attorneys for both sides are under a court order--requested by the defendant--not to discuss the amount. The plaintiff's attorney is Thomas Cacciatore, (213) 380-6330.

* * * * *

6) The burglar and the skylight.

The Wall Street Journal editorial stated, along with many others: "An insurance company is ordered to pay $260,000 plus $1,500 a month to a plaintiff when he fell through a skylight while burgling a school."

(more)

THE FULL FACTS: The insurance company in Bodeine v. Enterpise High School District was not ordered to pay anything; the case was settled. The man involved, Rick Bodeine, 19, had graduated from the high school in 1981. In 1982, as a lark, he and two friends tried to take a floodlight from the roof of the school to light their basketball court. The skylight had been painted the same color as the roof, so that there was no way to differentiate between the two. He fell through the skylight and was rendered quadriplegic. He is confined to bed, with loss of his speech as well as use of his limbs, because of massive head injuries and brain damage.

Eight months before this accident, a similar one had occurred in the same school district. (The skylights had been painted in most of the schools.) In this case, the victim died. As a result, school officials knew that having the skylights painted the color of the roof was dangerous and were in the process of correcting it. However, they had not yet moved to repaint Enterprise High School.

Settlement in 1984 was for $260,000 plus $1,200 per month, to be increased annually by 3%, for life, with a life expectancy of 50 years. The case never went to trial. Plaintiff lawyers are Alfred Naphan and James Glassford of Oakland, Calif., (415) 893-2265.

* * * * *

7) The fat man and the lawnmower.

This case has been cited in the Forbes article, The Wall Street Journal editorial, by Assistant Attorney General Willard, and others.

(more)

"An overweight man," wrote Forbes, "with a history of coronary disease suffered a heart attack while trying to start a Sears lawnmower. He sued Sears, charging that too much force was required to yank the mower's pull rope. A jury in Pennsylvania awarded him $1.2 million plus damages of $550,000 for delays in settling the claim. (Sears appealed but eventually settled out of court.)"

THE FULL FACTS: In Share v. Sears, a 32-year-old medical doctor, who had no known history of heart disease, was pulling the starting cord of his tractor lawnmower. When it did not start after 15 pulls, he suffered a massive heart attack. The jury found that the product was defective, because the cord was excessively hard to pull and the exhaust valve had a faulty clearance that did not meet the manufacturer's own specifications. As a result, the exhaust valve could not open enough to ease the pressure inside the engine cylinder during start-up. The incident occurred in 1977.

In 1984, the Philadelphia jury awarded $1.75 million: Sears did, indeed, abandon the appeals process and settle the case for a substantial amount. The amount of the settlement was sealed by the court by agreement of both parties. Keith Erbstein of Philadelphia represented the plaintiff, (215) 665-1000.

American Camping Association

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anni ersary

(203) 226-4389
5 Lockwood Circle
Westport, Connecticut 06880
March 24th 1986

Hon. Stuart McKinney, R-Ct.
U. S House of Representitives
Washington, D. C.

Dear Stu;

Sorry that I could not get to your hearing in Stamford today, but travels and the flu have kept me out of local circulation. I'm glad to hear that you are pursuing the issue of insurance and the problems dealing with liability protections, especially in view of your recent appointment to the Small Business Committee in the House.

Speaking both as a private business person, and as National Vice President in a volunteer position for my professional association, I had the priviledge of providing testimony on this same issue before Lowell Weicker's similar hearings in Washington just two weeks ago. Not only did Lowell's Small Business Committee start sessions on the issue, but my same comments were provided to Senate Commerce Committee hearings a few days later.

I thought it appropriate to furnish you with a copy of the testimony, altho the appending documents on economic impact are not included. If and when the House holds formal hearings on this matter, then I'd welcome the opportunity to testify and prewent facts as we did in the Senate. I'd think the House Small Business Committee would be vitally concerned with the problems, costs and availability of insurance for liability protection.

If my collegues or I can assist you or your committee please feel free to call.

Trusting you and the family are well, and with best of personal regards, I remain,

Cordially yours,

Alan J. Stolz, CCD
National Vice President

Encls.

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American Camping Association

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Sue Welch
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Preliminary Statement with Addendum by

The American Camping Association, on

The Liability Insurance Crisis and its Effect on

The Organized Camping Industry

Submitted by

Alan J. Stolz, C.C.D.
5 Lockwood Circle
Westport, Connecticut 06880
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National Vice President
American Camping Association
Martinsville, Indiana 46151

Before the Senate Committee on Small Business
Washington, D. C.

February 20th 1986

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Mr. Chairman, the American Camping Association, on behalf we are submitting testimony today, represents a vast segment of the organized camping interests in the United States. Since its inception in 1910, the Association, a nationwide, nonprofit, nonsectarian organization, has been committed to the continuing values and benefits unique to the organized camp setting. The ACA recognizes that through group living in the out-of-doors, both children and adults find special kinds of experiences that help them to develop physically, mentally, emotionally, and spiritually.

Over four million youngsters participate in summer camp yearly. They find diverse challenging activities in day camps and resident camps of many kinds -- privately owned, social agency or religiously affiliated, institutional, and special purpose camps, covering and protecting more than a million acres of prime recreational land across the United States. The ACA works with many groups and professional organizations to assure camping's accessability to individuals of all ages, including the elderly, the economically disadvantaged, the learning disabled, and those with physical impairments, among others.

Unfortunately, all this is threatened by the development of social and economic dependence upon insurance. The inability to secure insurance -- either due to unavailability or unaffordability -- has obvious implications.

The insurance difficulties of organized camps transcend the distinct differences of the multitude of different types of camps and camping. It makes no difference if you are the small family owned operation, or the big city agency program, the effect is the same -- erosion of important programs offerings, increases in participation fees, and most importantly a diminishment of the longstanding ability of organized camping to provide millions of children and adults the opportunity to participate in our unique programs.

Needless to say, the organized camps in this country have fallen victim to the current insurance trend. With the reams of testimony before the Committee, it may be to a large degree repetitive, to get into the horror stories which we most definitely share with other small business sectors.
It may, however, be instructive to take a brief look at the current statistical trend. Our most current data is three weeks old and is derived from a survey conducted by Mr. Stolz across the State of New Hampshire. We believe that this most recent data is indicative of the national trend, so we have decided to present this somewhat of a micro-economic look at the national situation.

It is interesting to note that this voluntary survey by mail, sent to every camp in the State -- of which there are 165 -- drew a response rate in excess of 50% in less than 72 hours. The speed of the response is to us an indicator of the degree of

concern shared by camp owners and operators. The survey revealed that one quarter (24%) of New Hampshire camps are considering closing their doors because of markedly increased premiums or unavailable coverage. One third (32%) have dropped key programs (horseback riding, boating, repelling, ropes, gymnastics, etc.) because of premium increases. An additional one sixth (16%) dropped key programs due to inability to find coverage. Not one camp which responded to the survey has had a serious loss, claim, or settlement to justify premium increases.

The insurance trend, as it relates to camping, is actually a continuum of sharp premium increases experienced in the seventies. As is the case currently, those increases were incurred without relation to loss experiences. Ten years ago the National Board of the ACA appointed an ad hoc insurance committee to examine the problems in the field, and suggest alternatives. After a year or so of study, the Committee recommended that a captive insurance company be formed. Initial approval was received, and a managing agency was retained to help with formation. Start up funds were secured as were commitments from the necessary number of camp directors, but the plan was aborted when efforts to secure reinsurance at reasonable rates proved unsuccessful.

At the time, the major problem in securing reinsurance was the lack of any history of losses in the camp field. The Committee went back to the drawing board and entertained bids for group insurance with the hopes of developing a strong program with heavy participation, which would as a consequence provide a history of losses.

That program commenced in 1982 with the Khulen Agency of Monticello, N.Y. Since that time, our insurance committee has been meeting annually with agency principals to study losses, with the objective of developing a loss history to make forming a captive a more viable future alternative. Unfortunately, the state of the current reinsurance market is undermining our efforts.

Consequently, the Committee was recently charged with the duty of investigating self-funded or self-insurance programs as an alternative to rapidly increasing premiums.

In the interim, insurance rates have climbed from 50% to 600% in camps with no loss histories. Insurance on a single horse has risen as high as $1,500.00 for a summer season. Camps have been forced to sign child abuse waivers, sometimes retroactively under threat of immediate policy cancellation.

What can be done to help alleviate the problem? We view the crisis -- and we have had a decade to look at it -- as

essentially tripartite. Tort abuse, insurance industry mismanagement or misdirection, and the under utilization of comprehensive risk management all have contributed significantly to the problem.

The order in which we have listed these joint causes is in no way indicative of their relative importance. In fact, if you look at the problem from the stand point of problem avoidance, versus problem resolution, the last cause, namely under utilization of comprehensive risk management, is of paramount importance. If we can better design a system to encourage accident avoidance, everyone except the plaintiff's attorney will win. In a climate where the insurance industry is sensitive to risk avoidance, you would think that risk management would be embraced with open arms. Yet getting experienced company risk managers to take a more active role is more often than not like pulling teeth. The American Camping Association has taken the initiative and has developed a comprehensive and effective safety standards program for use by our affiliated camps. We strongly recommend that the Committee take a long hard look at how the insurance industry and the private sector in general handle risk management. Stronger incentives -- other than fear of premium increases, which appear in any event to have little relation to loss history -- are needed across the board. The old adage that an ounce of prevention is worth a pound of cure could not hold truer than here.

Tort reform is perhaps the most popular of proposed solutions to the insurance crisis, at least from the standpoint of the unprecedented expansion of civil litigation in this country. It is our experience that the expansion of litigation is largely regional. For the sake of continuity, getting back to New Hampshire, the number of cases filed in that state actually dropped by 691 from 1980 to 1984. At the same time the State population rose by 10%, and the cost of living rose by about 30%. New Hampshire does not recognize punitive damages, and in its entire history has only had two verdicts in excess of $450,000. Yet liability insurance premiums, during that same period, rose 43% statewide. In short, New Hampshire, and indubitably many other States, are paying for the litigation arising under the laws of other jurisdictions.

Obviously the insurance crisis is not limited to regional sectors of the country. We are all sharing in the burden. This fact has led us to the conclusion that some degree of uniformity -- and a tightening of the reins if you will -- is in order with respect to our tort system. Eleven States have in their wisdom abandoned exemplary damages. Why then is a national movement to control excessive verdicts by limiting these damages met with cries of foul, and declarations that this concept is totally foreign to our deep rooted system of civil justice?

Similar arguments can be advanced with respect to caps on pain and suffering, the inequity of joint and several liability, the double cost of the collateral source rule, the erosion of the doctrine of assumption of risk, and caps on lawyers' contingency fees. It is very important to note that these issues pose problems not only with respect to product liability, but with service industries, such as ours, and virtually every other entity, both profit and non-profit, engaged in commerce. A balance must be struck between the deterrent effect of our civil justice system, and the detrimental effect of generating an over reliance on litigation. We strongly encourage the Committee to take whatever steps necessary, whether through the use of incentives to the states or Federal preemptive powers, to restore some semblance of balance to the system of civil justice we all value.

Likewise, we believe Congress should explore potential avenues of Federal oversight with respect to wayward insurance industry practices. The power of Federal purse strings, when it comes to providing incentives for state regulatory enforcement, is available and should be used if necessary.

From the insurance industry standpoint, the most apparent contributor to the current crisis was an over dependence on investment income, and an under reliance on prudent underwriting practices. We question the desirability of permitting a reoccurrence of this practice if our goal is stability.

There remain a number of other industry practices worthy of review. Most agree that the claims history of individual establishments should play a more direct role in premium calculation. An analogy can be drawn between the unemployment compensation program, where individual business employment histories are tracked for purposes of premium calculation -- and industry size, function, location, and other group factors are recognized as being largely irrelevant. Public policy should lend rewards -- greater than that of simply not being sued -- to establishments that implement safety programs with successful results.

A separate but related issue involves current rating systems which have a distorting effect upon true risk estimation. This is particularly so in the camping field, where insurer rating systems fail to recognize organized camps as independent risks. Camps are on the whole a heavily supervised, safety conscious industry, with a superlative loss ratio. Most camps, including those with American Camping Association accreditation, have comprehensive safety programs which form an integral part of their operation. Yet insurer standards assign ratings based upon a host of separate risk codes, too often totally independent of the camp situation. It is not uncommon for a small camp to be

rated with major liveries if it has a horse, with restaurants if it has a kitchen, with timber companies to the extent it is located in the woods, and with marinas if it has a canoe. This to us is a prime example where insurance industry convenience has given way to unrepresentative actuarial practice, at the cost of unnecessarily high premiums.

SUMMARY AND CONCLUSION

Organized camping is an important adjunct to our society. Every year private independent and non-profit camps serve over four million youths, from all social and economic backgrounds, and contribute over $4 billion to the national economy. These contributions are at great risk by virtue of abuses of the civil tort system, insurance industry mismanagement, and inadequate risk management programs.

Congress should use incentive legislation, or if necessary Federal preemptive powers, to make measured changes in tort liability standards and rules which address the entire system of commerce. Attention should not be limited to product liability, but should be extended to service industries, and all others similarly affected.

Congress should act on legislation to correct insurance mismanagement and ensure that those who create hazards share a greater burden of the cost. Likewise, there should be protection for organizations with no significant loss history.

Lastly, the Congress should pay greater attention to problem avoidance and prevention, and consider substantial incentives for improved risk management programs.

McDonald &
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April 1, 1986

The Honorable Stewart McKinney
Representative in Congress
915 LaFayette Street
Bridgeport, CT 06604

Dear Mr. McKinney:

After you held hearings in Stamford on the insurance crisis, I read the announcement in the local newspaper. I was chagrined to have missed the opportunity to attend, having experienced a 50% increase in my business insurance. Happily, it said you would return. Can I depend upon you instead of the newspaper for the future announcement?

It is my opinion that there is a similarity between the insurance industry and government in that both levy charges and dispense services. In that sense insurance premiums, like taxes, cannot be avoided. However, if insurance awards become inordinate windfalls, the system becomes as pernicious as a government lottery. A large tax is levied for the benefit of the few. The selection of the few is mostly capricious and so the dispensers will someday be judged as irresponsible. Government, I believe, has sullied itself by engaging in lotteries but need not compound the error by abetting the insurance industry with a legal system that looks like a crap game.

I suggest tort awards should be limited to property damage and lost income. Pain and suffering should have negligible, if any, value. After all, we are taught by our churches that life is a vale of tears without a prospect of cashing in on it.

I would welcome an opportunity to express these ideas publicly at your next hearing.

Very truly yours,

A. McDonald

ADM:lcm

APPENDIX E.—PREPARED STATEMENT OF WARD BROWN, REGIONAL ADVOCATE, REGION I, BOSTON, MA, SMALL BUSINESS ADMINISTRATION, REPRESENTING JAMES C. SANDERS, ADMINISTRATOR, SBA

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

I AM PLEASED TO BE HERE TODAY TO REPRESENT MR. JAMES C. SANDERS, ADMINISTRATOR OF THE SMALL BUSINESS ADMINISTRATION, WHO UNFORTUNATELY WAS UNABLE TO ACCEPT YOUR KIND INVITATION TO TESTIFY PERSONALLY ON THE IMPORTANT ISSUE OF INSURANCE LIABILITY. MR. SANDERS REQUESTED THAT I THANK THE COMMITTEE FOR THIS OPPORTUNITY TO SUBMIT HIS STATEMENT FOR THE HEARING RECORD AND TO READ PORTIONS OF IT FOR HIM. I ALSO WISH TO STATE THAT THE VIEWS INCLUDED IN MR. SANDERS' STATEMENT ARE HIS AND DO NOT NECESSARILY REFLECT THOSE OF THE ADMINISTRATION.

MR. CHAIRMAN, AN ALARMING NUMBER OF SMALL BUSINESSES ARE REPORTING DIFFICULTIES THEY ARE EXPERIENCING IN OBTAINING LIABILITY INSURANCE. WE ARE HEARING ABOUT THEIR INSURANCE

PROBLEMS FROM SEVERAL DIFFERENT SOURCES. A NUMBER OF INQUIRIES HAVE BEEN RECEIVED BY THE SBA'S "ANSWER DESK," WHICH IS A TOLL FREE NUMBER OFFERING SMALL BUSINESSES INFORMATION AND ASSISTANCE.

THE CALLS TO THE ANSWER DESK ARE STARTING TO BECOME ALL TOO FAMILIAR. SMALL BUSINESSES ARE REPORTING PREMIUM INCREASES RANGING FROM 20 TO AS MUCH AS 1000 PERCENT. IN MANY CASES THESE PREMIUM DOLLARS ARE PURCHASING LESS PROTECTION. AS COVERAGE HAS BEEN CUTBACK AND DEDUCTIBLES INCREASED. A NEW COMMERCIAL GENERAL LIABILITY (CGL) POLICY FORM BEING DEVELOPED TO INSURANCE SERVICES ORGANIZATION (ISO) WOULD ALSO INCLUDE CERTAIN LEGAL DEFENSE COST WITHIN THE POLICY'S COVERAGE LIMITS AND EXCLUDE COVERAGE FOR "SUDDEN AND ACCIDENTAL POLLUTION." FURTHERMORE, THE FORM PROVIDES COVERAGE ON A "CLAIMS MADE" BASIS INSTEAD OF THE BROADER "OCCURRENCE" BASIS WHICH WAS THE STANDARD UNTIL RECENTLY. IN ADDITION, THE NON-CONCURRENCE OF MATCHING CLAIMS-MADE EXCESS

COVERAGE OVER PRIMARY OCCURRENCE COVERAGE PRODUCES DANGEROUS GAPS FOR THE INSURED.

IN ADDITION TO HIGHER PRICES AND CUTBACKS IN PROTECTION, A NUMBER OF SMALL BUSINESSES ARE REPORTING THAT THEIR POLICIES ARE BEING CANCELLED AND THAT COVERAGE IS NOT AVAILABLE AT ANY PRICE. THIS IS PARTICULARLY TRUE FOR MANY NEW BUSINESSES, VIRTUALLY ALL OF WHICH ARE SMALL.

SMALL BUSINESSES IN A BROAD CROSS-SECTION OF INDUSTRIES ARE KNOWN TO BE HAVING INSURANCE AVAILABILITY AND AFFORDABILITY PROBLEMS. THESE BUSINESSES INCLUDE MANUFACTURERS, DAY CARE PROVIDERS, MEDICAL AND OTHER PROFESSIONALS, TRUCKING AND BUS COMPANIES, ESTABLISHMENTS WITH LIQUOR LICENSES AND COMPANIES HAVING ANYTHING TO DO WITH CHEMICALS OR HAZARDOUS WASTE. THE INABILITY OF BUSINESSES TO OBTAIN POLICIES TO COVER ENVIRONMENTAL RISKS HAS

REACHED CRISIS PROPORTIONS AND PROPOSED LEGISLATION FOR POLLUTION CLEANUP LIABILITY HAS ONLY EXACERBATED THE PROBLEM.

IN ADDITION TO THE NUMEROUS PHONE CALLS SBA IS RECEIVING, SMALL BUSINESS INSURANCE PROBLEMS HAVE SURFACED AS A PRIORITY ISSUE AT THE WHITE HOUSE CONFERENCES ON SMALL BUSINESS BEING HELD IN EACH OF THE 50 STATES. IN ALL BUT ONE OF THE CONFERENCES HELD TO DATE, LIABILITY INSURANCE AND PRODUCT LIABILITY PROBLEMS HAVE FORMED THE BASES FOR RECOMMENDATIONS FOR LEGISLATIVE RELIEF. THE MOST FREQUENT OF THE RECOMMENDATIONS FOR REFORM WAS SPECIFICALLY AIMED AT ACHIEVING A UNIFORM PRODUCT LIABILITY STANDARD. AS YOU KNOW, MR. CHAIRMAN, THE CONGRESS HAS NOT, AS YET, PASSED FEDERAL PRODUCT LIABILITY LEGISLATION. BOTH THE ADMINISTRATION AND THE SBA HAVE CONSISTENTLY SUPPORTED EFFORTS TO DEVELOP NATIONAL PRODUCT LIABILITY STANDARDS, YET IN ALMOST 10 YEARS NO PROGRESS CAN BE REPORTED.

INSURANCE TECHNIQUES WERE USED BY THE EARLY PHOENICIAN SHIP OWNERS TO POOL CARGO LOSSES. THE MODERN PROPERTY-CASUALTY INSURANCE MARKET CAN TRACE ITS ROOTS BACK TO EDWARD LLOYD'S COFFEEHOUSE IN LONDON, WHERE IN THE 1680'S SHIP-HOLDERS GATHERED TO SHARE THE RISK OF A VESSEL BEING LOST AT SEA.

IN 1752, BENJAMIN FRANKLIN FORMED ONE OF THE FIRST FIRE INSURANCE COMPANIES IN AMERICA.

THEN, IN 1869 THE SUPREME COURT RULED THAT INSURANCE CONTRACTS DID NOT CONSTITUTE INTERSTATE COMMERCE AND WERE, THEREFORE, NOT SUBJECT TO FEDERAL CONTROL. INDIVIDUAL STATES WERE ALLOWED TO SET UP THEIR OWN REGULATORY BODIES TO PROTECT CONSUMERS.
IN 1944, THE SUPREME COURT RULED THAT INSURANCE WAS NOT "WHOLLY BEYOND THE REGULATORY POWER OF CONGRESS UNDER THE COMMERCE CLAUSE." AND, THEREFORE, WAS NOT EXEMPT FROM ANTITRUST LAWS.

PRESIDENT FRANKLIN D. ROOSEVELT ASKED CONGRESS TO GIVE INSURANCE COMPANIES SEVERAL YEARS TO ADJUST TO THIS DECISION BUT INSTEAD CONGRESS IN 1945 PASSED THE McCARRAN-FERGUSON ACT (PL 79-15), WHICH GRANTED THE INSURANCE INDUSTRY A PERMANENT EXEMPTION FROM FEDERAL REGULATION AND ANTITRUST LAWS SO LONG AS IT WAS REGULATED BY THE STATES.

THAT ACT DID NOT BAR CONGRESS FROM ENACTING ANY LEGISLATION AFFECTING INSURANCE, AND IT HAS ACTED IN RESPONSE TO SPECIFIC PROBLEMS. IN 1968, FOR INSTANCE, IN ORDER TO ENHANCE THE REBUILDING OF RIOT-TORN CITIES, CONGRESS SET UP A FEDERAL RIOT INSURANCE PROGRAM THAT WAS EXPANDED IN 1975 TO PROVIDE CRIME INSURANCE FOR URBAN DWELLERS. (PL 90-448, PL 94-13). THE RIOT INSURANCE PROGRAM MADE MONEY BECAUSE DISTURBANCES DECLINED AFTER IT WAS INSTITUTED.

INSURANCE COVERAGE IS ALSO PROVIDED BY THE FEDERAL GOVERNMENT IN SOME AREAS THAT PRIVATE COMPANIES HAVE REFUSED TO TOUCH. SUCH AS: AGRICULTURAL CROPS. FLOOD-PRONE AREAS. PENSIONS. BANK AND SAVINGS AND LOAN ACCOUNTS.

IN THE MID 1970's CONGRESS HELD HEARINGS ON THE RISING COST AND SHORTAGE OF INSURANCE TO COVER MEDICAL MALPRACTICE HOWEVER. IT DID NOT LEGISLATE.

THEN IN 1981. IN ORDER TO MAKE IT EASIER FOR BUSINESSES TO OBTAIN INSURANCE AGAINST PRODUCT-LIABILITY CLAIMS. CONGRESS ENACTED THE "PRODUCT LIABILITY RISK RETENTION ACT" WHICH ALLOWED BUSINESSES NEEDING PRODUCT LIABILITY COVERAGE TO SET UP THEIR OWN INSURANCE POOLS OR TO PURCHASE INSURANCE POLICIES AS A GROUP. THIS LAW PREEMPTED STATE LAWS WHICH RESTRICTED SUCH ACTIONS. THERE ARE STILL STATE "ANTI-GROUP" LAWS. HOWEVER. THAT APPLY TO PURCHASERS

OF OTHER TYPES OF LIABILITY INSURANCE.

1. THE IMPACT OF THE INSURANCE CRISIS ON SMALL BUSINESS AND THE ECONOMY

FIRST, I WOULD LIKE TO PUT MY STATEMENT IN CONTEXT BY DESCRIBING THE ROLE OF SMALL BUSINESS IN THE ECONOMY. BUSINESSES WITH LESS THAN 100 WORKERS EMPLOY APPROXIMATELY 44 PERCENT OF THE PRIVATE SECTOR WORK FORCE. IN RECENT YEARS, SMALL BUSINESSES HAVE CREATED MORE THAN TWO-THIRDS OF OUR NATION'S NEW JOBS. IN ADDITION, SMALL BUSINESS HAS PRODUCED 2.5 TIMES AS MANY INNOVATIONS AS LARGE BUSINESS, RELATIVE TO THE NUMBER OF PEOPLE EMPLOYED. THE ABILITY OF SMALL FIRMS TO CONTRIBUTE TO THE ECONOMY IS BEING CHALLENGED BY THE COST AND AVAILABILITY OF COMMERCIAL LIABILITY INSURANCE.

SMALL BUSINESSES ARE HIT PARTICULARLY HARD WHEN THERE ARE SHORTAGES OF LIABILITY INSURANCE. IT IS DIFFICULT FOR MANY SMALL BUSINESSES OPERATING IN COMPETITIVE ENVIRONMENTS TO PASS HIGHER PREMIUM COSTS ON TO CONSUMERS. BECAUSE LIABILITY INSURANCE IS NOT A LUXURY ITEM BUT A NECESSARY EXPENSE OF DOING BUSINESS, SMALL BUSINESSES WILL HAVE TO FIND SOME MEANS OF PAYING FOR INSURANCE. IN MANY CASES, THIS MAY RESULT IN LIMITING BUSINESS EXPANSION AND REDUCING PAYROLL AND OTHER OPERATING EXPENSES. MOST SMALL BUSINESSES OPERATE ON VERY MODEST CASH FLOW AND DO NOT ENJOY THE FLEXIBILITY OF LARGE BUSINESSES TO DIP INTO PROFITS, RAISE PRICES, OR SHIFT COSTS AMONG VARIOUS LINES OF BUSINESS.

IN ADDITION, SMALL BUSINESSES MAY BE AT A DISADVANTAGE IN PURCHASING INSURANCE FROM CARRIERS. SMALL BUSINESSES PURCHASE LESS PROTECTION AND FEWER LINES OF INSURANCE THAN LARGE

BUSINESSES AND MAY HAVE LESS LEVERAGE IN NEGOTIATING FAVORABLE INSURANCE RATES. SMALL BUSINESSES MAY ALSO HAVE DIFFICULTY OBTAINING FAVORABLE RATES BECAUSE MANY INSURERS DO NOT EXPERIENCE-RATE PREMIUMS FOR BUSINESSES UNDER A CERTAIN SIZE. BECAUSE IT IS DIFFICULT TO GENERALIZE SMALL FIRMS' EXPERIENCE, INSURERS BASE RATES ON INDUSTRY-WIDE OR SUB-INDUSTRY CLASSES. THEREFORE, EVEN IF A SMALL FIRM CAN DEMONSTRATE A HEALTHY CLAIMS HISTORY, IT MAY NOT HELP THE FIRM TO ACHIEVE A MORE AFFORDABLE PREMIUM RATE.

AN ADDITIONAL FACTOR THAT PUTS SMALL BUSINESS AT A DISADVANTAGE IN BUYING INSURANCE IS ITS LACK OF IN-HOUSE EXPERTISE IN PURCHASING INSURANCE AND MANAGING RISK. IN MOST SMALL BUSINESSES THE BUSINESS OWNER MAKES INSURANCE DECISIONS ALONG WITH A HOST OF OTHERS, WHILE IN MOST LARGE BUSINESSES THERE ARE "RISK MANAGERS" ON STAFF, WHOSE SOLE DUTY IS TO PURCHASE INSURANCE AND ASSESS AND

MANAGE RISK. RISK MANAGERS HELP TO DEVISE AND IMPLEMENT PROCEDURES TO IMPROVE SAFETY AND QUALITY CONTROL. FROM THE INSURER'S PERSPECTIVE, A BUSINESS IS A MORE ATTRACTIVE CUSTOMER IF IT CAN DEMONSTRATE THAT, TO SOME EXTENT, IT HAS ISOLATED AND REDUCED POTENTIAL RISKS.

IN ADDITION TO SMALL BUSINESSES' DIFFICULTIES IN PURCHASING COMMERCIAL INSURANCE POLICIES, SMALL BUSINESSES ARE LESS ABLE THAN LARGE BUSINESSES TO PROTECT THEMSELVES BY SELF-INSURING BUT MAY FIND A SOLUTION IN A GROUP INSURANCE POOL. THE LIMITATIONS OF INSURANCE ALTERNATIVES FOR SMALL BUSINESS ARE DISCUSSED IN MORE DETAIL IN SECTION 3.

MANY SMALL BUSINESSES THAT CANNOT OBTAIN COVERAGE AT ANY PRICE MAY SIMPLY GO OUT OF BUSINESS, PARTICULARLY THOSE BUSINESSES THAT ARE REQUIRED BY LAW TO CARRY INSURANCE. SOME SMALL BUSINESSES

WILL CHOOSE TO "GO BARE" AND OPERATE WITHOUT INSURANCE COVERAGE, EXPOSING THE BUSINESS' AND, OFTEN, PERSONAL ASSETS TO POTENTIAL LIABILITY CLAIMS. FOR BUSINESSES OPERATING WITHOUT INSURANCE PROTECTION, IT WILL BE PARTICULARLY DIFFICULT TO OBTAIN FINANCING THROUGH COMMERCIAL LENDING INSTITUTIONS. TO AFFORD DRAMATICALLY INCREASED INSURANCE PRICES, SMALL BUSINESSES MAY DIVERT FUNDS FROM BUSINESS EXPANSION PLANS, PRODUCING A SIGNIFICANT LOSS TO THE ECONOMY OF JOBS, PRODUCTS, SERVICES AND INNOVATIONS. THIS LOSS INCLUDES NOT ONLY THE NUMBER OF SMALL BUSINESSES THAT CONTRACT OR FAIL, BUT ALSO THE NUMBER OF FIRMS THAT NEVER START-UP BECAUSE OF THE COST OR UNAVAILABILITY OF INSURANCE.

2. CAUSES OF THE PROBLEM

THERE ARE SEVERAL REASONS THAT EXPERTS HAVE OFFERED FOR THE CURRENT PROBLEMS SMALL BUSINESSES ARE EXPERIENCING IN OBTAINING LIABILITY INSURANCE. ONE OF TWO MAJOR REASONS ADVANCED IS THE CYCLICAL NATURE OF THE INSURANCE INDUSTRY.

THE "UNDERWRITING CYCLE" APPARENTLY OCCURS AS INSURANCE CARRIERS PRICE THEIR POLICIES LOWER TO BUILD VOLUME AND THEN FINANCE LOSSES WITH INCOME FROM INVESTMENTS. WHEN THE INVESTMENT INCOME DECLINES AND WHEN CLAIMS OCCUR ABOVE ANTICIPATED LEVELS, RATES MUST BE INCREASED AND RISKS REASSESSED. FURTHERMORE, THE PRIMARY INSURER DOES NOT RETAIN THE FULL EXPOSURE OF THE LIMITS OF THE POLICY, OFTEN "REINSURING" OR LAYING OFF AS MUCH AS 90% OF THE LIMITS TO OTHER INSURERS WHO SPECIALIZE IN REINSURANCE. IF THE RE-INSURERS ARE UNWILLING OR UNABLE TO CONTINUE TO WRITE THE INSURANCE, THE PRIMARY INSURER FREQUENTLY WITHDRAWS.

THE CAPACITY CONSTRAINTS OF THE INSURANCE INDUSTRY ARE RELATED TO THE INDUSTRY'S CYCLES AND CONTRIBUTE TO SHORTAGES OF LIABILITY INSURANCE. BECAUSE UNDERWRITING LOSSES ARE PARTIALLY PAID FROM "SURPLUS," WHICH IS THE EQUIVALENT OF A CORPORATION'S WORKING CAPITAL OR RETAINED EARNINGS, THE ABILITY OF AN INSURER TO WRITE POLICIES IS A FUNCTION OF ITS LEVEL OF SURPLUS. INTEREST RATES AND LOSSES DIRECTLY AFFECT SURPLUS LEVELS AND IN RECENT YEARS,

HEAVY LOSSES AND DECLINING INTEREST RATES HAVE ERODED INSURERS' SURPLUS. THE RESULT IS A LACK OF CAPACITY TO SUPPLY BUSINESS CONSUMERS' DEMAND FOR INSURANCE PROTECTION.

IT SHOULD BE REMEMBERED THAT DURING THE PERIOD OF 1980 THROUGH 1983, INSURERS WERE SLASHING RATES BY AS MUCH AS FIFTY TO SEVENTY-FIVE PERCENT EACH YEAR - HOPING THAT THE INVESTMENT RETURNS WOULD COVER THE LOSSES.

TO ENSURE THAT CARRIERS DO NOT WRITE MORE BUSINESS THAN THEY CAN AFFORD TO WHEN SURPLUS IS LOW, STATE REGULATORS SCRUTINIZE INSURERS' PREMIUM INCOME RELATIVE TO THEIR SURPLUS. REGULATORS FOLLOW A RULE-OF-THUMB KNOW AS THE "KENNY FORMULA," WHICH THEORIZES THAT PREMIUMS SHOULD NOT EXCEED SURPLUS BY MORE THAN 2 TO 3 TIMES.

GIVEN THE CURRENT SHORTFALL IN INDUSTRY CAPACITY, INSURERS ARE RAISING PRICES, CUTTING BACK ON PROTECTION, TURNING AWAY NEW

BUSINESS, AND CAREFULLY SELECTING THOSE BUSINESSES WHOSE POLICIES THEY WISH TO RETAIN. AS CAPACITY IS RESTORED, POLICIES SHOULD BECOME MORE READILY AVAILABLE AND INSURANCE PRICES SHOULD STABILIZE, IF NOT DECLINE.

KEEPING IN MIND THAT INSURANCE IS ONLY ONE WAY TO TRANSFER RISK (OTHER WAYS INCLUDE HOLD HARMLESS AGREEMENTS, LIABILITY WAIVERS, SELF-INSURANCE, POOLING AND ALL KINDS OF RISK MANAGEMENT TECHNIQUES), WE MUST EXAMINE THE MACHINERY THAT CREATES LIABILITIES AND ITS EXPANDING UNIVERSE. THIS IS, IN SHORT, THE EXPLODING UNIVERSE OF THE CIVIL JUSTICE SYSTEM - THE TORT LIABILITY THEATER. IT WOULD APPEAR THAT LITIGATION IS AMERICA'S NUMBER ONE GROWTH INDUSTRY.

EACH STATE HAS ITS OWN STATUTORY AND JUDGE-MADE TORT LAW WHICH MAY VARY SIGNIFICANTLY FROM STATE TO STATE. THE DIFFERENCE IN STATE LAWS MAKES IT DIFFICULT TO PREDICT, FOR EXAMPLE, THE POTENTIAL LIABILITY OF MANUFACTURERS FOR DEFECTIVE PRODUCTS THAT

MAY INJURE PERSONS IN SEVERAL STATES. INSURANCE CARRIERS ARE RELUCTANT TO UNDERWRITE LIABILITIES THAT THEY CANNOT ACCURATELY PREDICT. ADDITIONALLY, JUDGES AND JURIES ARE INCREASINGLY AWARDING DAMAGES TO AN EXPANDING GROUP OF PLAINTIFFS FOR HARMS THAT UNDERWRITERS NEVER INTENDED TO BE INCLUDED IN INSURANCE POLICIES. PARTICULARLY IN THE AREA OF PRODUCT LIABILITY AWARDS HAVE BEEN VERY SIGNIFICANT.

WAS IT EVER THE THEORY THAT PUNITIVE DAMAGES SHOULD BE A WINDFALL FOR PLAINTIFF'S ATTRONEYS - I THINK NOT - BUT THAT IS WHERE IT HAS EVOLVED TODAY.

3. SOLUTIONS TO THE INSURANCE CRISIS

WHILE INSURERS' COMPETITIVE PRICING PRACTICES CAN NOT BE DISMISSED AS A CAUSE OF THE CURRENT INSURANCE CRISIS, THE MOST EFFECTIVE MEANS OF RESOLVING THE CRISIS IS TO MAKE INSURANCE RISKS MORE PREDICTABLE. INCREASING REGULATION OF THE INSURANCE

INDUSTRY WILL NOT RESULT IN REDUCING INSURANCE AVAILABILITY. RATHER, IT WILL CAUSE INSURERS TO MOVE CAPITAL TO LESS RESTRICTIVE MARKETS, ULTIMATELY RESULTING IN AN EVEN MORE GREATLY DIMINISHED INSURANCE SUPPLY. CAPITOL IS ATTRACTED TO INSURANCE RISK-TAKING WHERE THERE IS A PREDICTABLE POSSIBILITY OF ADEQUATE RETURN FOR THE RISK.

TO BRING INSURERS BACK INTO THE MARKET PLACE, IT WILL BE NECESSARY FOR STATES TO ENACT REFORMS OF THE CIVIL JUSTICE SYSTEM. SOME OF THE REFORMS CURRENTLY UNDER CONSIDERATION BY STATES INCLUDE:

- RETURN TO FAULT BASED STANDARDS FOR LIABILITY

- BASE CAUSATION FINDINGS ON CREDIBLE SCIENTIFIC AND MEDICAL EVIDENCE AND OPINIONS

- ELIMINATE JOINT AND SEVERAL LIABILITY IN CASES WHERE DEFENDENTS HAVE NOT ACTED IN CONCERT

- LIMIT NON ECONOMIC DAMAGES SUCH AS PAIN SUFFERING AND PUNITIVE DAMAGES TO A FAIR AND REASONABLE MAXIMUM DOLLAR AMOUNT

- PROVIDE FOR PERIODIC PAYMENTS FOR FUTURE MEDICAL CARE OR LOST INCOME

- REDUCE AWARDS IN CASES WHERE PLAINTIFFS CAN BE COMPENSATED BY CERTAIN COLLATERAL SOURCES TO PREVENT A WINDFALL DOUBLE RECOVERY

- LIMIT ATTORNEYS CONTINGENCY FEES TO A REASONABLE AMOUNT ON A SLIDING SCALE AND ENCOURAGE USE OF ALTERNATIVE DISPUTE MECHANISMS TO RESOLVE CASES OUT OF COURT

A DIFFICULT QUESTION IN RESOLVING THE VARIOUS LIABILITY INSURANCE ISSUES WILL BE DEFINING THE RESPECTIVE ROLES OF THE FEDERAL AND STATE GOVERNMENTS. BECAUSE, HISTORICALLY, STATES HAVE ENJOYED RESPONSIBILITY FOR REGULATING THE INSURANCE INDUSTRY AND ESTABLISHING TORT LIABILITY STANDARDS, IT WILL BE MOST EFFECTIVE FOR THE STATES TO RESOLVE INSURANCE PROBLEMS. ONE POTENTIAL AREA OF FEDERAL INTERVENTION IS A NATIONAL PRODUCT LIABILITY STANDARD. FINALLY, THE FEDERAL GOVERNMENT MIGHT AMEND EXISTING LAW OR ENACT NEW LEGISLATION PREEMPTING STATE LAWS THAT RESTRICT THE ABILITY OF BUSINESSES TO PURCHASE INSURANCE POLICIES IN GROUPS OR TO FORM INSURANCE POOLS.

I HOPE THAT THE WORK OF THIS SUBCOMMITTEE AND OTHER CONGRESSIONAL COMMITTEES LOOKING AT THE ISSUE WILL RESULT IN A DETERMINATION OF THE PROPER ROLE OF THE FEDERAL GOVERNMENT IN RESOLVING INSURANCE PROBLEMS. HOWEVER, EXPERIENCE IN TRYING TO RESOLVE THE PRODUCT LIABILITY CRISIS AT THE FEDERAL LEVEL IS DISCOURAGING.

AT THE EXECUTIVE BRANCH LEVEL. THE ATTORNEY GENERAL HAS ESTABLISHED AN INTERAGENCY WORKING GROUP TO FOCUS ON A NUMBER OF TORT REFORM ISSUES. INCLUDING PRODUCT LIABILITY AND THE AVAILABILITY OF LIABILITY INSURANCE FOR BUSINESSES. THE SBA IS ASSISTING THE WORKING GROUP IN DEFINING SMALL BUSINESSES' INSURANCE PROBLEMS AND IN RECOMMENDING APPROPRIATE SOLUTIONS TO THE INSURANCE CRISIS.

IN THE SHORT-RUN. THERE ARE SOME PRACTICAL STEPS SMALL BUSINESSES WHO ARE HAVING DIFFICULTIES PURCHASING LIABILITY INSURANCE CAN TAKE. UNFORTUNATELY. FOR SOME NEW AND SMALL BUSINESSES. THERE MAY BE NO IMMEDIATE SOLUTION TO THE INSURANCE CRUNCH.

BUSINESSES SHOULD SHOP-AROUND FOR INSURANCE COVERAGE JUST AS THEY WOULD FOR ANY OTHER NECESSARY BUSINESS PRODUCT OR SERVICE. A NUMBER OF SMALL BUSINESSES THAT INITIALLY REPORTED POLICY CANCELLATIONS LATER INFORMED US THAT THEY WERE ABLE TO FIND SOME COVERAGE. ALTHOUGH SCALED-DOWN AND AT A HIGHER COST.

CONSUMERS SHOULD CONTACT STATE INSURANCE DEPARTMENTS TO SEE IF THERE IS A MARKET ASSISTANCE PLAN (MAP) OPERATING IN THE STATE. A MAP IS A VOLUNTARY ORGANIZATION OF INSURANCE CARRIERS WITHIN THE STATE WHICH ASSISTS BUSINESSES IN LOCATING DIFFICULT-TO-OBTAIN INSURANCE POLICIES. WHILE MAPs DO NOT GUARANTEE THAT A BUSINESS WILL OBTAIN COVERAGE, IN MANY INSTANCES, THEY MAY HELP A CONSUMER TO OBTAIN A SUITABLE INSURANCE POLICY.

SMALL BUSINESSES SHOULD DEVELOP RECORDS OF SAFETY PROCEDURES AND LOOK AT WAYS TO IMPROVE SAFETY AND QUALITY-CONTROL. IF POSSIBLE, SMALL BUSINESSES SHOULD FOLLOW THE LEAD OF LARGE FIRMS AND CALL IN RISK MANAGEMENT CONSULTANTS TO HELP ASCERTAIN RISK AND IMPROVE SAFETY PROCEDURES.

SMALL BUSINESSES SHOULD CAREFULLY EVALUATE THEIR INSURANCE NEEDS AND BE PREPARED TO ASSUME A GREATER AMOUNT OF RISK. THEY MAY BE ABLE TO NEGOTIATE BETTER POLICY TERMS IF THEY ACCEPT A HIGHER

DEDUCTIBLE AND ASSUME LIABILITY FOR SPECIFIED RISKS OR EVENTS. FOR THOSE UNINSURED RISKS, IT IS VERY IMPORTANT FOR THE BUSINESS TO EVALUATE AND IMPROVE ITS SAFETY AND QUALITY CONTROL.

ANOTHER POSSIBILITY FOR SOME SMALL BUSINESSES IS TO OBTAIN A POLICY THROUGH A TRADE ASSOCIATION. SOME TRADE ASSOCIATIONS ARE ABLE TO NEGOTIATE POLICIES FOR THEIR MEMBERS THAT MAY OFFER LOWER RATES THAN THE BUSINESSES COULD INDIVIDUALLY OBTAIN. IF THIS IS POSSIBLE, THE AFFORDABILITY OR AVAILABILITY OF AN INSURANCE POLICY MAY WELL JUSTIFY THE PRICE OF MEMBERSHIP IN THE TRADE GROUP. IT MAY ALSO BE POSSIBLE TO OBTAIN COVERAGE THROUGH THE TRADE ASSOCIATIONS MASTER OR GROUP POLICY, IF AVAILABLE. IN SEVERAL STATES, HOWEVER, THERE ARE LAWS THAT GENERALLY PROHIBIT OR RESTRICT THE ABILITY OF BUSINESSES TO PURCHASE INSURANCE IN GROUPS.

FOR SOME OF THE MORE PROFITABLE SMALL BUSINESSES, SELF-INSURANCE OR RISK-POOLING WITH OTHER BUSINESSES MAY BE A FEASIBLE

ALTERNATIVE TO CONVENTIONAL POLICIES. A SELF-INSURANCE RESERVE REQUIRES A BUSINESS TO SET-ASIDE FUNDS TO COVER FUTURE CLAIMS.[1] A GROUP POOL, SUCH AS AN INSURANCE CAPTIVE OR MUTUAL COMPANY REQUIRES CAPITAL CONTRIBUTIONS TO ESTABLISH THE POOL, IN ADDITION TO ONGOING PREMIUM COSTS. FOR MANY SMALL BUSINESSES, HOWEVER, THE COST OF SELF-INSURING OR RISK-POOLING IS PROHIBITIVE.

IN ADDITION TO THE COSTS, ONE OF THE MAJOR PROBLEMS WITH SELF-INSURANCE AND RISK-POOLING IS THE DIFFICULTY OF OBTAINING NECESSARY REINSURANCE. WITHOUT REINSURANCE OR AN UMBRELLA POLICY, THE SELF-INSURED'S OR POOL'S RESERVES WILL MARK THE EXTENT OF ITS PROTECTION; THE BUSINESS' UNDERLYING ASSETS MAY BE USED TO SATISFY CLAIMS BEYOND THE EXTENT OF RESERVES.

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[1]MONIES SET ASIDE FOR SELF-INSURANCE PURPOSES ARE NOT TAX DEDUCTIBLE; AMOUNTS ACTUALLY PAID OUT IN CLAIMS OUT OF RESERVES, HOWEVER, ARE DEDUCTIBLE. BUSINESSES CAN DEDUCT FROM INCOME PREMIUMS PAID ON A CONVENTIONAL INSURANCE POLICY.

SELF-INSURANCE AND INNOVATIVE GROUP-INSURANCE ALTERNATIVE WILL PROVIDE SOME BUSINESSES AND CITIES WITH NEEDED PROTECTION. WHILE PUTTING SOME COMPETITIVE PRESSURE ON CONVENTIONAL INSURANCE CARRIERS TO EASEUP ON PRICES AND AVAILABILITY. IT IS NOT CLEAR, HOWEVER, TO WHAT EXTENT SELF-INSURANCE AND INSURANCE CAPTIVES WILL PERSIST IN THE LONG-RUN AS COMPETITION IN THE CONVENTIONAL INSURANCE MARKET AS INCREASES AND PRICES BEGIN TO DECLINE. IN ADDITION, INCREASING LITIGATION AND DAMAGE AWARDS ARE AS MUCH A THREAT TO THE LONG TERM SOLVENCY OF ALTERNATE INSURANCE MECHANISMS AS THEY ARE TO STANDARD INSURANCE RATES.

THIS CONCLUDES MY PREPARED STATEMENT. I WILL BE HAPPY TO ANSWER ANY QUESTIONS YOU MAY HAVE.

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